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THE RONALD PRESS COMPANY

229 Broadway, New York

A MANUAL

OF

CORPORATE ORGANIZATION

CONTAINING

INFORMATION, DIRECTIONS AND SUGGESTIONS
RELATING TO THE INCORPORATION
OF ENTERPRISES

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BY

THOMAS CONYNGTON OF THE NEW YORK BAR
Author of "A Manual of Corporate Management"

NEW YORK
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1905

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PREFACE.

In this country the corporation has already become the favorite form of business organization. Its use is constantly extending. Every practicing lawyer is at times called upon to incorporate the business enterprises of his clients or to counsel them in regard thereto. The present work, treating the general subject of incorporation from a practical standpoint, is intended as a convenient manual of reference for such occasions.

The work is also intended to point as clearly as may be the advantages obtainable under the corporate form, and to suggest the ways and means by which these may be most effectually secured and conserved.

The value of the volume will probably be found to lie largely in these suggestions. The innumerable conditions that arise in the differing incorporations cannot all be specifically covered. The methods, instances and illustrations given will, however, the author trusts, cover the field so broadly that even though particular difficulties are not directly met, their solutions may still be drawn from the suggestions of the text.

The limits of space have prevented an exhaustive treatment of many of the legal points discussed. In such cases the law has been stated generally and with a view to the avoidance of anything questionable or hazardous. Where necessary, important points have been fortified by citations and quotations.

The work has been prepared for use in any part of the United States and without special reference to the laws of any particular section, though the author's more extended experience with the corporation laws of New York and New Jersey has led to their more frequent use for purposes of illustration. Wherever the book is used it will, of course, be in connection with the local statutes applicable to the subject.

The forms in Part VII are those most likely to be useful and suggestive in the organization of corporations. In most cases these forms are taken from instruments in actual use, names and local details only being changed.

In conclusion the author would state that this volume is intended to hold the same relation to the work of incorporation that his preceding volume "Corporate Management" bears to the work of the organized company. He can only hope that it may receive from his professional brethren the same appreciation that has been so generously accorded the former publication.

THOMAS CONYNGTON.

No. 170 Broadway,

New York City, December 1, 1904.

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CORPORATE ORGANIZATION.

PART 1.—THE CORPORATE SYSTEM.

CHAPTER I.

ENDS SOUGHT BY INCORPORATION.

§ 1. Desirable Features of Corporate Form.

Practically there are but two forms of business combination available for the conduct of a business or enterprise—partnership and the corporation. The one is easily entered into, and as easily dissolved, the other is formal and permanent. Men may drift into partnership; the law frequently implies it for them, or it is made by a simple verbal agreement. Incorporation, on the contrary, may be had only by deliberate purpose, carried into effect through prescribed forms of law. A partnership may, and frequently does, exist without the knowledge of the partners; an incorporation is impossible except with the formally expressed concurrence and participation of all the interested parties.

The general and steadily increasing preference for the corporation over the partnership as a form of business organization is due to the very material advantages offered by the former, which may be summarized as follows:

(*a*) Its limitation of stockholders' liabilities to a definite amount.

(*b*) Its distinct legal entity for all business purposes.

(*c*) The stability and permanence of its organization.

(*d*) The representation of the different interests in the corporation and its property by transferable shares of stock.

(*e*) The management of the business by an elected board of directors, acting through officers and agents.

(*f*) The greater ease of securing capital because of the safeguards and advantages of the corporation.

These characteristic features of the corporate form are severally considered in the following sections of the present chapter.

§ 2. Limited Liability.

The subscriber to stock, and the holder of stock not fully paid for, are liable to the corporation, and, indirectly, to its creditors, up to the par value of their stock. In most states of the Union a subscription involves no further liability. So soon as the face value of stock is paid, this liability ceases and the stockholder is no longer, as a stockholder, responsible in any way for the corporation and its doings. In some states in addition to the regular subscription liability, the stockholder is liable in case the corporation becomes insolvent, for a further amount equal to his original subscription—that is equal to the par value of the stock he holds. This double liability existed in Ohio until recently. It is still found in Minnesota and a few other states. The corporation cannot collect this additional amount but in case of its insolvency any creditor of the corporation may enforce payment. In California, each stockholder is liable for his unpaid subscriptions, and in case of insolvency is further liable for such proportionate part of the corporate indebtedness as his stock bears to the total capitalization of the corporation. Stockholders in national banks, and generally stockholders in banks, trust companies and other moneyed corporations, are, in addition to any subscription liability, held liable for an amount equal to the par value of their

stock in case of the insolvency of their corporation. In some few states stockholders may be held for any debt due a laborer, servant or other employee of the corporation.

These statutory liabilities are, generally speaking, unfortunate, because of their lack of uniformity and their uncertain action. Not infrequently they work serious hardships where stock is purchased in ignorance of their existence. They are always productive of litigation and the states in which they are found are to be avoided for purposes of incorporation. (See § 26.)

These statutory liabilities, however, exist in but a few states, and the general rule prevails that a stockholder whose stock has once been paid in full is neither liable to assessment by the corporation, nor to action by its creditors. The property of the corporation in which he is interested may be swept away, but his liability is fixed and limited. His investment will be lost but that is the worst that can happen. The unlimited responsibility of the partnership does not exist.

§ 3. Legal Entity of Corporation.

In the partnership every member must be made a party to all actions either by or against the firm, and no partner may sue or be sued by the partnership. He cannot contract with his firm, nor enforce its obligations to him. The great inconvenience of this is manifest. On occasion it results in serious loss and injustice. It is a material defect of the system.

The corporation, on the contrary, is a distinct legal entity, entirely apart from its membership. It may sue and be sued under the corporate name. It may contract freely with its stockholders and even, under proper conditions, with its officers and directors. It may bring suit to enforce these contracts, and in its turn may be sued by stockholders, officers or directors. In short, for all purposes of ordinary business, the corporation has a distinct, individual existence of its own.

§ 4. Permanence.

The partnership depends for its continued existence upon the continued life, sanity, solvency and consent of each one of its members. It is always readily, and often unavoidably, terminated, and this easy and at times undesirable dissolution, with its possible resulting loss of business, good-will and reputation, is a serious defect of the system.

In the corporation, permanence and stability are characteristic features. The organization endures until terminated (1) by voluntary dissolution, which must usually, though not invariably, be by unanimous consent of the stockholders, or, (2) by the expiration of the period for which it was formed, or, (3) by the insolvency of the corporation, or (4) by forfeiture of charter by the state. These are the only legal methods by which the corporation is terminated. The lives, the mental or financial condition of its stockholders, the antagonism of an individual or faction, need have no effect on its existence. This permanence adds materially to the value and efficiency of the corporation as a mechanism for the transaction of business.

In some few states the maximum term for which charters are granted is twenty years. In others it is fifty. In others there is no limitation, and the duration of the corporation may be fixed at any desired period, or may be made—at least in name—perpetual.

§ 5. Stock System.

In a partnership there is no satisfactory or generally recognized method of expressing and representing the individual interests of the partners. Nor is there any way, save by consent of all the parties interested, by which a partner may transfer his interest in whole or in part to another person. Such a transfer, unless by general agreement and adjustment, dissolves the firm.

In the corporation the exact reverse obtains. Under a

fixed and well-ordered system, the various interests of the parties in whom the ownership of the corporate property rests are expressed as equal parts, or shares, of the whole. These shares are represented by quasi-negotiable certificates which may be transferred as desired, with but little formality and without affecting the operations of the corporate business. The convenience and the obvious business advantages of this method are most attractive features of the corporate system.

§ 6. Corporate Mechanism.

The stable, well-defined and orderly system of administration, characteristic of the corporation, is an admirable and important feature. The election of a board of directors by the stockholders voting according to their stock interests, the election of officers and the appointment of agents by this board for the direct conduct of the business, the supervision and control of these officers and agents by the board, the orderly action of the board as a body at meetings called in accordance with by-law or charter requirements, constitute the best working mechanism for the conduct of a business enterprise that has yet been devised.

The several functions of the stockholders, directors and officers, the well-defined laws and usages governing every feature of corporate operation, the records to be kept, the reports to be made and the protection afforded its members, combine to make a system compared with which the workings of the partnership are crude and inadequate.

Like the federal system of government, the corporate organization is based on a division of powers and duties and the operation of mutual checks and balances. If well arranged and properly conducted its operation is effective and satisfactory. It must be observed, however, that the ideal corporate organization is not ordinarily attained. It is often lost through ignorance, negligence or lack of experience. Safeguards and checks may be omitted or purposely set aside by promoters and exploiters. A charter and by-laws well adapted for one

corporation are often stupidly duplicated for another of wholly different design and composition.

To avoid these errors and to secure an effective and smoothly working corporate mechanism, requires skill and intelligence in the organization of the corporation. To maintain its proper operation thereafter demands an honest, capable administration or watchful care on the part of those interested.

It may be stated in passing that no system of conducting business has been or can be devised that will protect the interests of those concerned, automatically and without effort on their part. The best laws are of no effect unless enforced, and the most effectual and well-devised system of business organization may be wrested to evil ends unless the efforts in this direction are opposed. All that can or should be done is to afford the weak an opportunity to protect themselves if the need arises. If they will not avail themselves of the opportunity when the time comes, it is they that are at fault, not the system.

§ 7. Attractiveness to Investors.

Speaking generally, any considerable combination of capital is impossible under the partnership system. No matter what the merits of the enterprise, nor how great the inducements offered, they are outweighed by the dangerous liabilities and uncertain operation of the unincorporated form. For this reason any appeal to the investing public on the basis of a partnership, or of a joint stock association is foredoomed to failure.

On the other hand, the corporate form has been found most attractive to investors. It enables them to invest or participate to a definite extent without rendering themselves indefinitely liable. It has a continued period of duration, usually lasting until insolvency or voluntary liquidation. The business interest obtained may be sold, transferred or transmitted to posterity, with little formality and without material expense. Its mechanism operates in well-defined grooves and the rights

and liabilities of all concerned are well known. It has its own personality, and stockholders are not involved by its actions or responsible for its obligations.

For these reasons, if it is desired to raise capital for an enterprise, or to increase the amount already invested, the obvious method, and the one almost invariably pursued, is to incorporate the undertaking and sell the securities of the company so formed.

In this connection it may be observed that if the attractiveness of the corporation as a field for investment is to be preserved, it is essential that those features shall be maintained which serve to protect the interests of the investor. This has not been the case in many recently floated incorporations. Exorbitant and even fraudulent prices have been paid for properties. Undue power and emoluments have been given to the original promoters. Rights of minority stockholders have been denied, and the smaller investors have been debarred from any knowledge of the inner corporate operations.

The immediate result of such practices has been to divert much investment money to the safe haven of the savings bank and the life insurance policy, where returns are small, but where all the conditions are clearly defined, and where both principal and profits are secure.

§ 8. Conclusions.

From the preceding considerations it seems that the characteristic features of the corporate form which have led to its extended use are: (1) Its efficiency which is curtailed only by ignorance or lack of skill in its organization; (2) its convenience which is inherent in the corporate system and requires no special attention; (3) its safety which is the one point above all others that requires attention, not only because it is the one most apt to be overlooked, neglected or omitted by intent, but because it is the most important feature of any business enterprise in which a number of people are concerned.

The corporation is, from its nature, a democratic institu-

tion, and the safety of the investors' interests should be a first essential. The majority must rule, but the rights of the minority demand that this rule be fair, open and honest. Due adjustment of all equities should be made so that all interests are represented, none favored at the expense of others, the general business facilitated and the profits fairly apportioned. This is the true ideal of corporate organization, and, speaking generally, that corporation is the most ably organized and conducted which most nearly approaches this ideal.

CHAPTER II.

SUBSCRIPTION LISTS AND CONTRACTS.

§ 9. General.

In former days the subscription list was regarded as a necessary preliminary to incorporation. It was circulated either to determine whether sufficient support could be obtained to justify the proposed incorporation, or, if this were already known, to commit the subscribers definitely before the organization was actually undertaken.

In the present day the application of the corporate form has been extended and somewhat modified, and the attendant procedure has changed. Now the corporation is usually organized first, property of some kind is taken over, and stock is then sold or subscriptions solicited to raise any needed capital. Under this plan the subscription list is of much less prominence and importance than formerly.

There are, however, still cases of incorporation in which the preliminary subscription is employed and is, at times, essential. The farmers of a neighborhood may wish to establish a creamery, or a fruit-evaporating plant; in some growing town the citizens may wish to combine their efforts for the construction of an electric plant, the organization of a bank, the opening of a library, or the establishment of some local industry. In such event, the subscription list would be circulated as the first step toward the formation of the contemplated corporation.

Also in other cases, memoranda or agreements are entered into between the parties interested, which are the equivalent of the subscription list and are the preliminary and definite steps toward the intended corporate organization.

§ 10. Nature of the Subscription Contract.

Prior to the organization of the corporation, the ordinary subscription is merely a continuing proposition from the subscriber to the proposed corporation for the purchase of a specified amount of its stock. At this stage the subscription is not a complete and enforceable contract because the other party thereto—the proposed corporation—has no legal existence, and, until the corporation is formed, the death, insanity or voluntary withdrawal of the subscriber would cancel the proposition and thereby terminate the proposed contract. After the corporation is organized and by either express or implied acceptance of the subscriptions to its stock, has completed the contract, the subscription list becomes a binding agreement between the parties thereto, and the corporation may, if necessary, bring suit for specific enforcement.

To avoid this possibility of revocation, characteristic of the ordinary subscription list before acceptance by the corporation, subscriptions are frequently made payable to trustees, who act for the corporation in the matter, undertaking its organization, and, where desirable, the collection of the subscriptions in whole or in part. Under such a contract, properly drawn, the subscriptions, if unconditional, are binding as soon as made; if conditional, as soon as the conditions are fulfilled.

The acceptance of a subscription by the corporation not only renders the contract a binding one, but also, of itself, constitutes the subscriber a stockholder of the corporation. If his subscription is made to a trustee for the corporation, he becomes a stockholder so soon thereafter as the corporation is organized and his subscription turned in by the trustee. In either case nothing further is necessary to legally establish him in this position, nor in the enjoyment of his rights as a stockholder. The delivery of the stock certificates, while a formal recognition of this status, confers nothing beyond a convenient evidence of his stock interest that he did not have before. Even though the subscriber never paid his subscrip-

tion, he is a stockholder from the time of the acceptance of his subscription until such time as by proper procedure his subscription is canceled or forfeited for non-compliance with its conditions. (Wheeler *vs.* Millar, 90 N. Y., 353, 1882.)

It is to be noted that the corporation when organized is under no compulsion to accept or recognize subscriptions to its stock. The subscriber is not bound; neither is the corporation until the contract is completed by the acceptance of the subscription by this latter. If the subscription is made to a trustee for the corporation and is accepted by him, this would make a binding contract between the subscriber and the trustee, but would not bind the corporation until acceptance, express or implied, by this latter. If the corporation accepted the benefit of the trustee's acts it would thereby also accept the trustee's contracts, from which such benefits accrued. The very fact of the organization of the corporation by the trustee, or trustees, might be held to be an acceptance of the subscription contracts which rendered such incorporation possible.

Usually, however, the acceptance of subscriptions by the corporation does not enter into consideration, such acceptance following its organization as a matter of course. Litigation may be necessary to compel payment of subscriptions, but hardly to compel their acceptance by the corporation.

Subscriptions made as a part of a prescribed statutory form of incorporation would be irrevocable as soon as made.

After the completion of any subscription agreement by the recognition of both parties thereto, it becomes a simple contract and subject to the usual laws of contracts.

The subscription to stock must be distinguished from an agreement to purchase stock. In the first instance the subscriber becomes a stockholder immediately upon the acceptance of his subscription by the corporation. In the latter case he does not become a stockholder until the consummation of his agreement and the delivery to him of his certificates of stock. A subscription list might be so worded as to be merely an agreement to purchase stock, in which case, the subscribers

would not be stockholders until they received their certificates of stock. (See § 11.)

§ 11. Form of Subscription Contract.

Generally, the form of the subscription list is of small importance if the intent of the parties is clearly expressed. Except for the difficulty of proof, a verbal subscription, if within the provisions of the statute of frauds, would be binding and entirely sufficient.

As a matter of ordinary precaution, however, the subscription list should be prepared with due regard to form and with a clear presentation of all important details. The name of the proposed corporation, its general purpose, its capitalization, the par value of shares, the state in which it is to be incorporated, and the conditions under which the subscription is made, all should be set forth with precision. Enough should be included to prevent any question as to the nature of the subscription and the conditions under which it was made. (Woods Motor Vehicle Co. *vs.* Brady, 181 N. Y., 1905.)

Where it is inconvenient to go into full details in the subscription list proper, a general statement, or prospectus, is frequently prepared and accompanies the list. Where this is done the statements of this prospectus become a part of the representations upon which the subscriptions are secured, and must be lived up to in all essential details if the subscription is to be held.

Any material variation from the statements of the subscription list, such as a change of capital, or purposes, or location, would release the subscribers. For this reason, only those details should be stated explicitly in the subscription list that have been fully decided upon; any undecided points being either omitted, or stated as undecided, or otherwise so covered that no matter how finally settled the subscriptions previously secured will not be affected. For instance, if the name of the proposed corporation has not been finally determined, the list might be headed with any suggested name, as "The Smith Separator Company," but the body of the document state that

the subscriptions were made to the stock " of a corporation to be organized under the name of ' The Smith Separator Company,' or such other name as may be later determined." Subscribers to such a list could not plead any voidance of their subscriptions no matter what name was eventually selected. Or if the capitalization were not definitely settled, the subscription list might fix sufficiently elastic limits by the use of such phrases as " not less " or " not to exceed " according to the conditions.

At times individual subscription blanks are sent out instead of a single list. At other times several similar lists are circulated as a matter of convenience. If properly worded to show their common purpose, these separate lists will for all legal purposes be held as a single list.

The subscription list should be clearly and unmistakably a subscription and not an agreement to subscribe in the future or to purchase stock later. As a general rule the courts construe subscription agreements very liberally in accordance with what appears to be the intent of the parties, but a direct statement that " We, the undersigned, *hereby agree to subscribe*, etc.," instead of the proper form, "We, the undersigned, *hereby subscribe,* etc.," might have a very different legal effect from that intended. (General Electric Co. *vs.* Wightman, 3 App. Div., N. Y., 118 (1896); Yonkers Gazette Co. *vs.* Taylor, 30 App. Div., N. Y., 334 (1898); Lake Ontario Shore R. R. Co. *vs.* Curtiss, 80 N. Y., 219, 1880.)

It is to be noted that under the common law, unless otherwise specified in the agreement of subscription, the entire capital stock of the proposed corporation must be subscribed before any of the subscriptions are binding and enforceable. In some of the states this has been modified by statute, but otherwise prevails, and where it is desirable that subscriptions for a less amount than the entire capital stock should hold, the subscription list should so specify. It is competent for the subscription list to fix this amount at any desired figure and the subscriptions will be binding provided the other requisite condi-

tions are fulfilled, so soon as the specified amount is secured.

Any person competent to contract may make a binding subscription for stock. A subscriber for stock need not necessarily be an incorporator of the company, though usually an incorporator must be a subscriber to the company's stock. One corporation cannot usually subscribe for the stock of another corporation, though it might be permissible in the case of a corporation authorized to hold the stock of other corporations.

§ 12. Underwriting Agreements.

In the organization of the larger corporations, and more especially those designed to effect industrial combinations, it is usually very important and at times absolutely essential either that funds be raised in advance of the time when the corporate securities can be offered for sale, or that there be some positive assurance that the necessary funds will be derived from the sale of these securities when they are ready to be offered. Under such conditions the use of the ordinary subscription agreement would, at the best, be ineffective and in most cases absolutely impracticable. Under such circumstances recourse is had to the modified form of subscription agreement known as the underwriting agreement. (See Chap. XXXIV, Underwriting.)

CHAPTER III.

CONTRACTS PRIOR TO INCORPORATION.

§ 13. Status of Corporation upon Organization.

When a corporation comes into existence, it is usually without debts, contracts or obligations of any kind, save those expressed in its charter and in the statute law of the state of domicile. It is not bound by anything done or said before its incorporation unless embodied in its charter, or in its by-laws or involved in the procedure of its organization. A corporation cannot be bound before it exists as no one could then act with authority as its agent or representative.

After its organization, the corporation may recognize or accept any contracts it sees fit, and this applies to contracts made on its account before its incorporation. Such acceptance may be express or implied. If the corporation takes the benefit of such a contract it is liable thereon without any express recognition or formal acceptance. For example, if offices had been leased for the corporation before its incorporation, and the corporation, when organized, occupied the offices it would be liable on the contract without further acceptance. If the corporation did not occupy the offices but by a proper resolution recognized the contract and assumed the rent, it would be liable. If it neither occupied the office nor assumed the lease, there would be no acceptance either express or implied and the corporation could not be held. The whole matter rests in the discretion of the corporation.

§ 14. Status of Contracting Parties.

Contracts are continually entered into by incorporators, promoters or trustees for and on account of unorganized cor-

porations. These contracts are entered into on behalf of the corporation and in its interests, but the party who enters into any such contract is himself liable in the absence of an express agreement to the contrary until the assumption of the contract by the corporation. Then, if it was understood that he was acting in the interests of the corporation, the party directly contracting is relieved of liability, the corporation taking over the liability in his stead. If, however, there were no such understanding, the party who originally made the contract would be responsible, unless the other party agreed to his release, even after the contract was taken over by the corporation.

For example, take the case of offices leased for the use of a corporation. If leased with the clear understanding that the party making the lease was acting for the unorganized corporation, such party would be personally liable, and if the corporation failed to assume the lease, could be held for the full amount, but so soon as the contract was assumed by the corporation would be released. If, however, the lease were taken without a clear understanding that the party was acting for the corporation, he would not be relieved when the corporation took over the lease—unless by consent of the lessor—but would still be liable, and, should the corporation fail to pay its rent, might be called upon to make good the deficiency.

For this reason, in making contracts for the benefit of an unorganized corporation, the fact that they are being made for such proposed corporation should be clearly recognized and expressed. The parties making such contract should also recognize their own liability in the matter, and, if there is any uncertainty as to the ultimate organization of the corporation or its acceptance of the contracts, should make such contracts dependent upon acceptance by the corporation or else be prepared to assume the responsibility themselves.

§ 15. Agreements between Incorporators.

There is another class of agreements relating to the unorganized corporation, of a very different nature. These are the

understandings or agreements between the incorporators, or other interested parties, defining the nature of the proposed corporation, its purposes and often the details of its organization and management. Between the parties these agreements are perfectly proper and legitimate, but affect the corporation only so far as they may be incorporated in its charter or by-laws.

It is to be borne in mind that provisions may be incorporated in the charter, or made part of the by-laws, in pursuance of a contract, or as a consideration for a contract, in such wise that their subsequent alteration or repeal can be effected only by consent of the interested parties. One partner may agree to the incorporation of the partnership business on condition that certain provisions be embodied in the by-laws, the maintenance and observance of such provisions constituting part of the consideration for the transfer of the partnership property. Such by-law provisions, properly incorporated and duly adopted, would be extremely difficult if not impossible of revocation without the consent of all parties concerned. (Kent *vs.* Quicksilver M. Co., 78 N. Y., 159; Lowenthal *vs.* Rubber etc., Co., 52 N. J. Eq., 440.)

Formal agreements between promoters as to the subject matter of a charter can rarely be specifically enforced, and the only recourse of the aggrieved party is a refusal to participate in the subsequent organization of the corporation, or, if damages can be shown, a suit against the offending parties for their breach of contract.

Often agreements in regard to incorporation are mere verbal understandings. Usually, if not carried out, these only result in the refusal of the aggrieved party to move further in the matter, such agreements not ordinarily furnishing sufficient basis for litigation.

§ 16. Promoters' Contracts.

The general doctrine that no one is authorized to contract for a corporation before it is formed applies to all contracts

with and by promoters. The promoter is himself liable on these precorporate contracts, unless otherwise expressly provided, but the corporation is not.

For example, as is frequently the case, the promoters of an enterprise may agree with an attorney for its incorporation, authorizing him to attend to the whole matter, including disbursements, preparation of seal, printing, etc., the amount of his professional fee being agreed upon in advance. On the organization of the corporation, its directors might disclaim the whole matter and the attorney would have neither recourse nor claim against the corporation on account of his contract with the promoters. The corporation having utilized his legal services in its incorporation would probably be held for a fair fee, though this is not certain, and for the necessary disbursements, such as the state fee, notarial charges, filing fees, etc. Such claims would, however, have to be based on their own merits, not on the terms of the agreement made with the promoters. That agreement would have no standing as against the corporation, and should this latter reject the seal, printing, etc., the attorney would have no ground to proceed against the corporation therefor, but must look to the promoters. (Re Empress Engineering Co., L. R. 16, Ch. D., 125, 1881.)

The most difficult questions arising under contracts with promoters relate to the sale of property to the corporation. It is a matter of almost daily occurrence for promoters to dispose of property to corporations organized by them for the express purpose of taking over such property. For discussion of this somewhat complicated subject see Chapter XXXII, Issuance of Stock for Property, and Chapter XXXIII, Concerning Promoters.

§ 17. Option Contracts.

In the formation of corporations, and, especially, in the formation of combinations, it is frequently necessary that options be secured in advance of the actual incorporation. As

these options may be—and often are—absolutely essential to the enterprise, they must be secured before the corporation is formed, and frequently involve very considerable expenditures of money.

Nothwithstanding the importance of these contracts and their peculiar nature, they fall under the general rules governing precorporate contracts. If accepted they become the contract of the corporation; if rejected the corporation cannot be held. If the corporation refused to take over any such option contracts, the party obtaining or holding same would have no claim for compensation or for damages on account of any payments made by him thereon or in connection therewith. He might have some claim against his associates, if they made any promises to him in regard to the options, or authorized him to procure them, but the corporation would not be involved, except by its voluntary consent.

§ 18. Trustees' Contracts.

When the organization of a corporation is contemplated, not infrequently a trustee, or trustees, will be selected to act for the inchoate corporation. Some arrangement of the kind is necessary where subscriptions to the stock of the corporation are to be made binding before its organization. Also, usually, it is advisable to have definite parties in charge of the matter, who have power to act for the subscribers and who will attend to the details of the incorporation.

Such trustees frequently collect payments on subscriptions, make disbursements in the interest of the new enterprise, and, in some cases, actually carry on the undertaking until such time as the corporation may be advantageously organized and put in control of the going concern.

No matter how far such trustees may have carried the corporate affairs, nor to what extent they may have contracted in the interests of the corporation, they have the same individual liability on these contracts and the same inability to force them on the corporation, as in the case of any other precorporate contracts.

The coign of vantage occupied by the trustees is found in the fact that they are in control of the organization, and, where contracts of any importance have been entered into by them on behalf of the corporation, or disbursements made, or obligations entered into, they will see that these are properly assumed by the corporation before its control passes from their hands. Then, if these contracts have been entered into in proper form, so that the assumption by the corporation releases the trustees, these latter, barring fraud, are thereafter absolutely free from any liability on account of their pre-corporate undertakings.

§ 19. Effect of Failure to Incorporate.

When contracts are entered into in expectation of the formation of a corporation and on its behalf, their status if the corporation fails of incorporation depends upon the nature and condition of the contract. A subscription to its stock, no matter how irrevocable, would be terminated, and, if payments had been made thereon to a trustee, any unexpended amount might be reclaimed, and, if the trustee were to blame for the failure to incorporate, he might be responsible for the portion expended as well. Most other contracts, if clearly made on behalf of the proposed corporation, would be terminated. If not clearly so made, the parties acting for the corporation might be held to specific performance, or for damages for non-performance. If the contracts were made with the distinct understanding that they were for the benefit of the proposed corporation, the parties acting for the corporation could not insist on performance for their own benefit, unless with the consent of the contracting parties.

CHAPTER IV.

WHERE TO INCORPORATE.

§ 20. General.

If the corporation laws and imposts were uniform in every state of the Union, or if the whole matter were regulated by general Federal laws, the best location for any particular corporation would be easily determined. It would then, as a matter of course, be organized in that state in which the principal operations were to be carried on, or in which its headquarters might most conveniently be located.

There is, however, great variation in the cost of incorporation in different states, also in the rates and methods of taxation after incorporation. The general requirements and regulations imposed on corporate operations also differ widely.

Owing to the material differences in the costs, regulations and requirements of the several state laws, taken in connection with the fact that a corporation organized in one state may, under more or less restriction, or lack of restriction, do business in any other state, the selection of the place for incorporation frequently becomes a balancing of the comparative advantages and disadvantages of the available states. The low taxes of one state will be weighed against the more liberal corporation laws of another; the liabilities of a convenient state with the freedom therefrom of another less available; the benefit of incorporation under desirable laws in an "outside" state, with the addition of the burdens imposed on foreign corporations in the "operating" state, as against direct incorporation in this latter; or the privileges allowed by one state as against the immunities enjoyed under the laws of another.

§ 21. Domestic Incorporation.

Within the boundaries of the state by which it was chartered, a corporation is a domestic corporation—outside these boundaries it is a foreign corporation. Within its own state, a corporation has certain recognized powers and privileges as a matter of right. Outside it has only such powers and rights as may be accorded foreign corporations by the laws or customs of the particular state. These vary greatly in the different states. In some, foreign corporations are discriminated against, while in others upon compliance with the prescribed formalities the foreign corporation has the same status as the domestic corporation.

As a rule a corporation should be organized in that state in which its principal operations are to be carried on, and this rule should not be departed from unless to gain some distinct advantage. At times, however, there will be weighty reasons that justify the selection of an outside state for incorporation. Also it often happens that the business of a corporation must of necessity be conducted in a number of different states. In such case it is usually domiciled in but the one state and thereafter transacts business in the others as a foreign corporation. The selection of the home state then becomes purely a question of expediency and advantage. (See § 101.)

§ 22. Foreign Incorporation.

A corporation is not a citizen of the United States and has no claims to the privileges and immunities of citizenship under the Constitution. It is an artificial creation of the state in which it is incorporated, and in that state is endowed by common and statute law with certain rights, powers and immunities. It also usually has the right to carry on its operations in other states with all the powers and privileges it enjoys in its home state. These other states may, however, if they so desire, ignore the fictitious

personality of the foreign corporation, refuse it recognition, debar it from initiating litigation in the state courts, consider it a partnership if litigation be brought against it, or even entirely prohibit its corporate operations within the state boundaries, except in so far as such operations may be protected by the provisions of interstate commerce.

Generally, however, no such discrimination is exercised against the foreign corporation. In most if not all the states, laws will be found providing for certain fees and requirements as a pre-requisite to the exercise of the corporate rights by foreign corporations within the state, but upon compliance with these demands they are admitted freely and are usually accorded all the rights of domestic corporations.

Some states have gone even further than this, as in New York, where for many years domestic corporations were subjected to high fees, burdensome reports and possible liabilities, which were not imposed upon foreign corporations doing business within the state. As a consequence the citizens of New York when desirious of incorporating a local business or enterprise would resort to other states for the purpose. Thereafter the corporation so organized did business in New York as a foreign corporation and this though all the parties interested resided in the state and all the corporate business was transacted there.

This practice gave rise to litigation to determine the right of citizens to incorporate elsewhere when the corporate business was to be conducted in the state, but the decisions were uniformly and unreservedly in favor of such right. (Merrick *vs.* Santvord, 34 N. Y., 206 (1866); Demarest *vs.* Flack, 128 N. Y., 205, 1891.) In other states the same question has arisen and has been so uniformly decided in the same way that the principle may be regarded as firmly established.

In some states liabilities exist of so onerous a nature as to render foreign incorporations most desirable, as, for

instance, the double liability of Minnesota and some other states, imposed upon the stockholders of certain corporations organized in those states. Under ordinary conditions the stockholders of a foreign corporation doing business in such states escape this double liability altogether, being subject only to such liabilities as were imposed by the corporation laws of the state of organization.

In this connection it is to be noted that the State of California, in which a special liability is imposed upon stockholders of domestic corporations, sought to extend this same liability by statute provision to the stockholders of foreign corporations doing business within the state. This liability was sustained by a decision of the Supreme Court of the United States as against the California stockholders of a Colorado corporation doing business in California. (Pinney *vs.* Nelson, 183 U. S., 144, 1901.) In this case, however, the corporation was organized in Colorado, mainly by citizens of California, for the express purpose of doing business in this latter state, and this purpose, with unusual and perhaps unnecessary frankness, was specifically set forth in the charter. Without such charter statement, or in the case of an ordinary foreign corporation doing business in California, it is doubtful if the statute liability would be sustained even against California stockholders though the matter has not yet been adjudicated.

It may be stated as a general rule that if corporate business of any importance is to be carried on in a foreign state all the requirements of that state in regard to foreign corporations should be complied with as a matter of business policy and expediency. If they are not so complied with, the usual penalty is the refusal of corporate recognition by the foreign state. The corporation may then still carry on business within such foreign state, its property is safe from confiscation and it cannot be prevented from bringing suit in all proper cases in the United States' courts in that state. Beyond this, however, it has no status. It cannot enforce a

contract or collect a debt in the state courts. If sued, it will be treated as a partnership and its stockholders considered as partners.

§ 23. Cheap Incorporation.

Resort to outside corporation on account of its cheapness is legitimate but not always wise. The cheap states have their advantages, but the excellence of their corporate regulations does not figure among these. Nor is the status of their incorporations as a class so far removed from reproach as to render the association entirely desirable for reputable organizations.

Occasions will occur when temporary or experimental incorporations are desirable, or where the conditions are such that the cheapest incorporation must be made to serve, or where the laxity of corporate regulation is regarded as advantageous. Then the cheap localities will be sought.

Speaking generally, however, the ease and cheapness with which incorporation may be secured in these localities draws to them most of the unsubstantial enterprises, illusive undertakings and fraudulent schemes that adopt the corporate guise for their dubious careers. These give character to the incorporations of these localities, and the very fact that a corporation is organized in a cheap state is in itself a circumstance requiring explanation and tending to discourage the experienced investor. In other words the corporation is in bad company and is likely to suffer the usual results of such association.

An even more material objection to the states of cheap incorporation is found in the fact that their corporation laws are crude, incomplete, and, for the most part, unadjudicated. Nor is there any reasonable assurance of the permanency of the existing laws. Obviously they have been compiled hastily, and without requisite care and consideration, and they are liable to be amended or altered at any time with equal haste and lack of judgment. The pos-

sibilities in this direction are illustrated by the corporate career of West Virginia. Up to 1901, West Virginia had a virtual monopoly of the cheap incorporation business, and derived therefrom a large and very profitable revenue. In the year mentioned, without previous warning, and without obvious reason beyond an ill-judged avarice, the state legislature raised the corporate fees and taxes materially, making them complicated and burdensome. The result was the practical destruction of the incorporating business in West Virginia. Most of the outside corporations already in the state re-incorporated elsewhere, new incorporations ceased to come, and West Virginia is no longer considered an available resort for incorporators from other states.

§ 24. Reputation of Different States.

Each of the incorporating states has a general reputation in corporate matters, primarily arising from the character and operation of its corporate legislation and from the security afforded thereby to corporate investors and creditors, but actually derived from the character of the corporations organized under its laws.

This reputation is of much importance to corporations intending to offer their securities to intelligent investors. In the cheaper localities, on account of this cheapness and the accompanying laxity of the corporate laws, such reputation is distinctly bad. The mere fact that a corporation is organized in Arizona, South Dakota or the District of Columbia is sufficient to put experienced investors on their guard and renders the sale of corporate securities difficult. Of all these localities the District of Columbia ranks lowest. In framing its laws it is probable that Congress intended merely to provide a simple form of incorporation for local enterprises. These laws have, however, been wrested to other ends, and at the present time no state in the Union is turning loose upon the investing public such an utterly irresponsible swarm of visionary, inflated and even fraudulent incorporations as is the Dis-

trict of Columbia, under the express sanction of Congress. So soon as that body wakes to the fact that it has established a breeding ground for corporations of dubious repute, the corporation laws of the District will unquestionably be amended so as to stop the whole business or put it on a reputable basis.

Among the more moderate-priced incorporating states Maine stands well and is resorted to by many Eastern corporations. Delaware has a fair reputation and Connecticut's reputation where known is good.

New Jersey is the most popular state of the Union for outside incorporations of large capitalization, and its reputation is excellent. Massachusetts stands high, on account of the conservatism of her laws, while Pennsylvania, Illinois and other important states lying between also stand well. New York, under its present law, ranks as high as any state in the Union.

§ 25. Corporate Laws of Different States.

Where important business interests and valuable property rights are involved it is of great advantage that the system of corporate laws should be full, comprehensive and judicially determined.

Of all the states of the Union, New Jersey has probably the advantage in this respect. She was the first to enact an effective and liberal system of corporate law. Incorporators from all over the country were attracted by the excellence of these laws. In the course of time the important points of doubtful status came up in litigation and were finally settled. From time to time, as defects were discovered, her corporation laws were amended, until to-day, save as to a few points, she has probably the most generally satisfactory system of corporation laws to be found in this country.

The New York laws have always ranked well, but until recently imposed unnecessarily onerous liabilities on directors and stockholders. The fees were also excessive. These features have been removed and at present the New York incorpo-

ration laws are satisfactory and the system of taxation is exceptionally fair.

In permanency, another most important feature of corporate laws, New Jersey again stands exceptionally high, and the cheaper localities correspondingly low. In New Jersey the corporate system has been gradually shaped into a nearly permanent form requiring but little change, and, save for some few occasional laws passed, apparently, for the accommodation of particular corporate interests, her Legislature has shown a commendable reluctance to interfere with these laws, unless for their obvious betterment. In most of the other states of the Union more or less modification of the existing corporation laws is to be expected before a permanent form is reached. In states such as New York, Pennsylvania, Massachusetts, Illinois, California, these changes are not likely to be radical, as the property interests involved are too extensive to permit of any material modifications of the laws by which these interests are held and administered.

§ 26. Liabilities Imposed in Different States.

When the selection of a state for incorporation is under consideration the special liabilities attaching to directors and stockholders of a corporation are matters for careful investigation. The unusual stock liabilities found in Minnesota, California and some few other states are very serious, if not insuperable, objections to incorporation in these states. In the cheap localities the usual liability on unpaid stock exists, but there are no special liabilities of either directors or stockholders, except, possibly, in the District of Columbia, where the statutes prescribe that stock may be issued for property "to the actual value thereof." Under this phraseology it might, on occasion, be held that the directors had erred in judgment, and that stock issued for property and supposedly full-paid thereby was not full-paid, but subject to further calls. (See Chap. XXXII, Issuance of Stock for Property.)

In the more important incorporating states stockholders

generally have no liabilities save on unpaid stock, though in New York there is a somewhat futile liability on indebtedness to employees of the corporation. This applies only to debts owing to subordinate employees, is usually small in amount and is seldom enforced.

Directors are in most of the states only held liable for negligence or direct fraud.

§ 27. Protection of Minority in Different States.

This feature is at times of very great importance. It could hardly be satisfactorily secured in either Arizona or the District of Columbia, special charter provisions not being permitted in those localities. In South Dakota, while special charter provisions are not allowed, the right to cumulative voting is effectually secured by the constitution of the state, and the minority is to that extent protected.

In New Jersey and New York protection may be secured by charter provisions. In Maine it may only be had by by-law enactment, which, as the by-laws are subject to repeal by the majority, is practically no protection. (See Chap. XXXVI, Protection of Minority.)

§ 28. General Rules for Selection of State.

Uusually the selection of the place of incorporation will be determined by the particular conditions. The more important of the few general rules that can be given are as follows:

(1) A corporation having but one plant or place of business, in which all or the greater part of its capital is involved, should be incorporated in the state where that plant or place of business is located.

(2) Any large corporation, or industrial combination, formed to transact business or operate plants in a number of states will, for the reasons already given, find incorporation in New Jersey advantageous. Its tax rate is higher than in some of the other incorporating states, but is not excessive.

(3) Temporary incorporations, some few close corporations, purely speculative corporations, incorporations of doubtful stability, and all other corporations desiring the maximum of capitalization with the minimum of expense and restriction, will naturally gravitate to the bargain-counter localities, where the cost of incorporation is nominal.

CHAPTER V.

COST OF INCORPORATION.

§ 29. General.

The direct expenses of incorporation are the initial taxes paid the state authorities, counsel fees, the incidental fees for filing and acknowledgments, and the cost of the corporate equipment. Thereafter the expenses are presumably the same as for an unincorporated concern, save for the annual franchise tax and possibly an increased property taxation that may result from the greater difficulty of evasion under the corporate form.

The incidental expenditures are usually trifling. The initial state fees and the subsequent annual taxation are more serious. As, however, these differ greatly in the various states, only a general consideration of the subject can be undertaken here.

§ 30. Fees and Franchise Taxes.

In deciding upon a locality for incorporation the matter of fees and taxes is often given undue importance. Unless the saving is considerable, it is rarely expedient to incorporate in a foreign state on that account alone. In many cases really important advantages are sacrificed for the sake of immaterial savings in fees. The following tables give the fees for incorporation and annual taxes in a few of the states most utilized for general incorporation purposes.

COMPARATIVE TABLE OF ORGANIZATION EXPENSES.

Including all Filing and Incidental Fees.

CAPITAL STOCK OF COMPANY.	NEW JERSEY.	NEW YORK.	DELAWARE.	MAINE.	SOUTH DAKOTA.
$1,000	$35 00	$16 00	$35 00	$27 00	$13 00
5,000	35 00	17 50	35 00	27 00	13 00
10,000	35 00	20 00	35 00	27 00	13 00
25,000	35 00	27 50	35 00	67 00	13 00
50,000	35 00	40 00	35 00	67 00	18 00
100,000	35 00	65 00	35 00	67 00	18 00
500,000	110 00	265 00	90 00	67 00	23 00
1,000,000	210 00	515 00	165 00	117 00	28 00
5,000,000	1,010 00	2,515 00	765 00	517 00	43 00
10,000,000	2,010 00	5,015 00	1,515 00	1,017 00	43 00

COMPARATIVE TABLE OF ANNUAL FRANCHISE TAXES.

$1,000	$1 00	$1 50	$0 50	$5 00	None.
5,000	5 00	7 50	2 50	5 00	"
10,000	10 00	15 00	5 00	5 00	"
25,000	25 00	37 50	12 50	5 00	"
50,000	50 00	75 00	25 00	5 00	"
100,000	100 00	150 00	50 00	10 00	"
500,000	500 00	750 00	250 00	25 00	"
1,000,000	1,000 00	1,500 00	500 00	50 00	"
5,000,000	4,000 00	7,500 00	2,000 00	150 00	"
10,000,000	4,250 00	15,000 00	2,150 00	275 00	"

It is to be noted that all such tables of comparative expenses are misleading without some explanation. For instance, the annual taxes of the preceding table are based on the supposition that in each case the entire stock of the corporation is issued and outstanding. Also the annual taxes as given are exclusive of the usual tax imposed on any real or personal property held in the state, which is taxed in all respects as if owned by an individual. In New York the annual tax varies with the conditions, and, as given in the table, is based on the supposition that (1) all of the capital is issued and (2) is employed in the state, and (3) is paying six per cent. dividends.

In the table as given the usual incidental expenses of each state have been included as part of the organization tax. These incidental fees vary. In New York they amount

to $15; in New Jersey $10; in Delaware $15; in Maine $17; in South Dakota $3; in Arizona $20 to $30; while in the District of Columbia they are nominal.

The comparative cost of incorporation only comes up for consideration when foreign incorporation is contemplated. In all such cases the cost of keeping up a state office and agent in the selected state is to be added to the usual expenses. This would vary from $25 to $50 annually for corporations of moderate capitalization, and usually includes assistance in holding annual meetings in the state and such attention to state reports as is demanded by the local law.

It is to be noted that the annual franchise tax in New Jersey and Delaware is a considerable sum. In New York, a corporation doing all its business outside of the state, and merely maintaining an office in the state for its books and meetings, pays no annual franchise tax. This fact is generally overlooked in selecting a corporate home for corporations doing business in many states. The annual franchise tax in Maine is moderate. In the District of Columbia, Connecticut, South Dakota, Arizona, and some other of the western states there is no annual franchise taxation. In considering the question of cost, it is to be remembered that foreign corporations are usually required to pay license fees and taxes in the states in which they do business, and often foreign incorporation merely adds the cost of the outside incorporation to the taxes that cannot be avoided in the state in which the corporation conducts its operations.

§ 31. Avoiding Fees and Taxation.

As stated elsewhere, it is usually advisable for an incorporation to be taken out in that state where the principal business is to be conducted. At times, however, the incorporating fees are so excessive that the corporation is forced to resort to another state where the fees are less onerous, doing business in its own state thereafter as a foreign cor-

poration. For instance, had the Steel Trust incorporated in Pennsylvania, which would naturally have been its home state, its initial fees would have amounted to over $3,500,000. In the state selected—New Jersey—these fees amounted to but $220,000.

Such incorporation in a less expensive state is the most obvious method of avoiding or reducing excessive state fees, but it is not always practicable. Conditions may exist which fix the state of incorporation despite the question of fees, and it then becomes a matter of importance to reduce these fees and the annual taxation thereafter to the lowest possible figure.

Where a corporation is organized to take over a business or property it is often possible and frequently distinctly advantageous to issue bonds in part payment for the property taken over. The necessary capitalization of the company is thereby reduced by just the amount of this bond issue, and the state fees and the state taxation thereafter are also proportionately less. Also, in many states, the corporation, in rendering its statement of taxable property, is allowed to deduct any outstanding indebtedness. The bond issue is an entirely legitimate indebtedness and as such in these states is deducted from the taxable property of the corporation in ascertaining the basis of taxation. This law was sustained by the decision in People, etc., *vs.* Barker, 139 N. Y., 63 (1894), an extreme case, where the corporation under consideration had an outstanding bond issue of $2,250,000, an amount far in excess of its total capital stock, and at least twice the amount of its actual assets. In this decision the Court said:

> "This indebtedness must in the nature of things be taken into consideration in arriving at the value of the capital of the relator. And when it is seen that the indebtedness of a corporation is double the amount of all its assets, it follows, upon the system adopted by the State for the assessment of corporations that the actual value of the capital of such a corporation is zero."

In some states a corporation is taxed in the place where its principal place of business is located, and this principal place

of business is named in and fixed by its charter. This obtains in New York. Accordingly, the Union Steamboat Company of that state, operating principally in Buffalo, where it employed twenty steam propellers and conducted a profitable business, selected by charter designation an obscure little hamlet in the southern part of the state as its principal place of business. Here taxation was low and assessors lenient and the company made good the statement of its charter by renting a room, putting up its sign thereon and holding its annual meeting therein.

This went on without objection for some six years, when the Buffalo assessors woke to the fact that the city was not receiving its apparent dues, and thereupon promptly assessed the corporation on some $600,000 of personal property. The company paid the tax under protest and then brought suit to recover the amount so paid. Judgment was in favor of the corporation and on appeal to the highest court was sustained. The court in its decision (Union Steamboat Company *vs.* City of Buffalo, 82 N. Y., 351, 1880) stated that if the scheme was a device to avoid taxation the evil must be corrected by other authorities, not by the courts.

It was to be supposed that the legislature would, in accordance with the suggestion of the court, have promptly remedied this defect in the corporation laws, but, although it is now more than twenty years since this case was decided, nothing has been done, and many New York corporations have since availed themselves of this legal method of evading taxation.

A more intricate method of avoiding taxation sometimes followed is the organization of a company with the desired name, purposes and capitalization in some state, as Maine, South Dakota or Arizona, where taxation is nominal, stock being issued for property in apportionment of interests and for other purposes as necessary. This is the actual corporation. A small operating company is then incorporated in the state in which the business is to be really conducted, with the same name and purposes, but with a nominal capitalization,

possibly only one per cent. of that of the larger corporation. The smaller corporation then acts as the local agent of the larger corporation, under such arrangement as the particular conditions indicate, the larger corporation not appearing actively in the conduct of the business.

The small corporation is either managed so as to make no profits, all these being diverted to the larger corporation, or if it is to be a profit-making concern, its stock is held by the stockholders of the larger corporation in due proportion. The officers of the smaller corporation would usually be the same as for the larger corporation, and this latter might guarantee accounts, or otherwise assist the small corporation with its credit.

It is obvious that organization fees and taxes would by this method be largely avoided, and that both state and local taxation thereafter might be materially lessened if not almost entirely evaded. The general plan is, however, difficult and complicated and requires the assistance of able counsel for its successful execution.

In some states taxes are arranged upon a sliding scale, depending upon the rate of dividends paid. Where this is true, close corporations may advantageously reduce their dividends by the disposal of profits as salaries, instead of allowing them to accumulate and be distributed as dividends.

In many states manufacturing corporations are either entirely released from the payment of state franchise taxes or are granted a more liberal basis or rate. Such exemption would naturally be claimed as far as possible.

The whole system of taxation is unsatisfactory and inequitable. Many corporations make false returns, shift cash accounts, manufacture fictitious indebtedness and resort to other expedients of doubtful legality or morality, in order to relieve the burden of taxation. The methods heretofore outlined and such others along the same lines as the statutes of the various states may allow, while legal, are not free from criticism. They are to a certain extent evasions of

the spirit of the law. If, however, the legislature in its wisdom has decreed that a corporation organized with both stock and bonds shall have these latter deducted from the former in order to establish its taxable status, or that an obscure village where taxes are light may be selected by a wealthy city corporation as its principal office for taxation, there would seem no valid business reason why corporations should not take advantage of the situation while it lasts and avoid all such taxation as may be without fraud and subornation of perjury. The same is to be said of the practice of incorporating in an outside state where taxation is less and doing business at home as a foreign corporation. It is not a manifestation of the highest spirit of civic patriotism, but it is not so repugnant to this spirit as are the perjury and falsification which too often prevail in the matter of tax returns.

§ 32. Counsel Fees.

The corporation is a creature of the law and in its formation every requirement of the law must be carefully observed. It is not sufficient that the corporation be merely brought into existence. With the aid of a printed charter form, and a ready-made set of by-laws, even the inexperienced may do this. It must be incorporated under the proper forms and with approved arrangements and with such knowledge of the conditions and possibilities that it secures every legitimate advantage allowed or permissible under the laws which authorize its creation. For this reason lawyers, and the inevitable concomitant, lawyers' fees, are important features of any incorporation in which actual values are involved.

Where cheap incorporations are imperative, or where the character of the incorporation does not justify the employment of an attorney, the incorporating agencies are usually employed and charge from $25 to $50 for their services in conducting the incorporation. This incorporation is then secured in one

of the cheaper incorporating states and is not usually worth more than the amount paid.

For the better class of incorporations where a really sound and effective organization is desired the fees of any qualified attorney would hardly be less than $50, and from this would range far upward according to the complexity of the arrangements, the standing and experience of the counsel and the increase of responsibility as property values increase.

It is to be noted that an incorporation differs from the conduct of litigation in the fact that the amount of work and responsibility involved may be estimated in advance with reasonable accuracy. For this reason the prospective counsel fees may be determined with precision and are usually agreed upon before incorporation is undertaken.

The reputation of the counsel employed may not only have a direct bearing on the charter and value of an incorporation, but may, and frequently does, assist materially in the subsequent sale of corporate securities and in the general welfare of the corporation. If the incorporation counsel rank high, his name in connection with the corporation is not only a guarantee of its technical correctness, but of the propriety of its purposes, the solidity of its undertaking, and, generally, of the status and character of the whole enterprise. For this reason the fees of counsel eminent in this line rank far above any justifiable compensation for the work actually involved in the incorporation.

§ 33. Corporate Equipment.

The cost of the stock books, certificates, seal, etc., necessary or usually employed in connection with a corporation varies widely according to the nature of the outfit. The ordinary corporation of moderate capitalization and pretensions, desirous of restricting its expenditures may secure everything necessary, and in neat and attractive shape, for the modest sum of $10. This includes stock certificates, printed on lithographed

blanks, the corporate seal, minute book, stock book and transfer book.

If a handsomer outfit is required, with special lithographed designs for certificates, and more impressive bindings on the books, the price of the outfit will easily run up to $40 or $50 and more. If specially engraved certificates are requisite or desired, this price will be increased to anywhere from $100 to $500, according to designs, character, etc.

The corporate books of account need be no different either in kind or cost from those used by the unincorporated concern.

PART II.—STOCK AND STOCKHOLDERS.

CHAPTER VI.

THE CAPITALIZATION.

§ 34. Basis of Capitalization.

In the earlier history of the business corporation, its capital stock was usually determined by the amount deemed necessary for the particular enterprise, or by the amount of cash subscriptions which could be secured for its exploitation. In either case the capitalization was intended to represent the actual cash or property values originally invested in the enterprise.

At the present time, the theory of capitalization has been somewhat modified and extended, and even in conservative operations, at least a portion of the earning value is included in the original capitalization.

The general theory is simple. Any enterprise may be considered as worth the amount upon which, with due regard to sinking fund and maintenance requirements, it can pay fair dividends and may justly be capitalized at that figure. In other words, the earning capacity of the enterprise rather than the cash value of the property involved forms the modern basis of capitalization.

As stated by a writer of eminence in financial matters in a recent discussion of this method:

> " It is not good financing to capitalize a company at only the value of its tangible assets—as if any sum over that value was ' water.' A manufacturer who does not on the average earn considerably more than the usual

rate of interest upon the actual cost of his plant might better go out of business and invest his money in bond and mortgage. Business men consider themselves entitled to at least 12½ per cent. upon their actual capital. If, then, assuming high earnings when forming a combination, a banking house should issue preferred and common stock in amounts each equal to the value of the plant, it would not be stock watering. The difference between cost of plant and earning capacity, whether we call it value of patents and trade-marks or good-will, is just as legitimate an asset of a company as is its merchandise, though harder to appraise properly." (Thomas L. Greene, in *New York Times.*)

If fairly done and kept within reasonable bounds, this general basis of capitalization is hardly open to serious objection. On the contrary, in many cases there are substantial business reasons for its adoption. If the enterprise be capitalized on the basis of its immediate cash or cost value, it may, and should, if meritorious, pay dividends far above the regular rates of interest or the usual returns on invested funds. The fact of the stock paying unusual dividends inevitably attracts attention, provokes opposition and invites competition.

Also stock in a dividend-paying concern may usually be sold at a better price on a large capitalization, if this latter be justified by the dividend paid, than it possibly could on a more conservative valuation.

For instance if an enterprise were capitalized at such a figure, say $200,000, that it could earn and pay a regular annual dividend of 6 per cent., its stock should sell readily at par, or 100. If its capitalization were reduced one-half namely $100,000, so that its regular annual dividend became 12 per cent. the stock having twice the earning power, and representing the same corporate property, should, theoretically, sell at twice par, or 200. As a matter of fact it would do nothing of the kind, ordinarily bringing from 175 to 180 according to circumstances and showing the "cashing" value of the smaller capitalization to be from

10 to 12½ per cent. less than that of the larger. That is, the smaller capitalization would involve a loss on the sale of the entire capital stock of from $20,000 to $25,000. As long as this is true, enterprises will be capitalized on their earning capacity rather than on their actual immediate value.

Also if capital is to be raised for the newly organized corporation, the larger capitalization, if within reasonable limits, gives much the better basis for the sale of stock. Greater inducements—at least in appearance—may be offered the buyer, and from the standpoint of future transactions the position of the buyer himself is better.

For these and other reasons the general practice at the present time, even in conservative circles, is to capitalize at that amount upon which the enterprise or undertaking may be reasonably expected to pay fair dividends—that is, the earning capacity is made the basis of capitalization. The practice is often deprecated and may easily be carried to a point at which it becomes alike dangerous, and at times dishonest. Kept within reasonable bounds, however, it would not seem to be objectionable either from the standpoint of morals or sound finance and it does give certain legitimate advantages. (See Chapter XXXII, Issuance of Stock for Property.)

§ 35. Capitalization at Less than Real Values.

In many cases the owners of small businesses in which but a few people are interested and to which others are not to be admitted, find it advantageous to incorporate at a capitalization much below the real value of the concern. Other conditions also arise in which the corporation with capitalization below its real value is a convenient business mechanism. The arrangement is frequently advisable where sales of stock are not contemplated and in all those cases where merely an apportionment of interest is desired under the corporate form. The fees and taxes are thereby kept at the minimum, the attention of competitors is not

attracted, the organization itself may be made very simple and every purpose of the incorporation is effectively fulfilled.

In states where a tax is levied on the capital stock, such tax may be largely and legitimately avoided by a small capitalization. If it is essential that the full values be represented in some way, the small capitalization may still be retained if desired, and the excess be covered by the issue of bonds or debentures.

In those small and close corporations where profits threaten to become excessive as compared with the capitalization, the dividend rate is sometimes kept down by the distribution of surplus profits under the guise of salaries. It need hardly be said that the plan can only be adopted with justice and safety when all the stockholders participate in due proportion in these liberal emoluments. If fairly carried out the practice is legitimate. The reduction of profits is sometimes effected by less defensible methods.

§ 36. Capitalization at Real Values.

In banks and other financial institutions this is the invariable rule. Beyond this, in those states where a double liability attaches to the stock of financial institutions, the more solid of these put the subscription price at double the par value of their stock in order to cover this liability in advance. At the same time they thereby establish a reserve equal in amount to their capitalization.

In most mercantile businesses it is usual to approximate the real value of the enterprise in the capitalization. Such valuation may, it is true, include good-will, trade names and the other more or less intangible assets of the business that differentiate the going concern from a dead stock of goods. In any established business, however, these values are quite as actual as any of the more material properties, and are quite as properly included in the capitalization.

§ 37. Capitalization on Earning Capacity.

This is the rule in capitalizing corporate combinations and public utilities. Usually bonds, or preferred stock or both are issued to the extent of the real values; then common stock is issued to such amount as the estimated earning capacity will carry after payment of the dividends and interest on preferred stock and bonds. The overwhelming volume of watered stock emanating from these sources is due to the excessively optimistic estimates of earning capacity made by the promoters. If the earning capacity were actually equal to the burden imposed upon it, the large issues of stock would, from some points of view, be fully justified, but, in most cases of this kind, the dividends are uncertain and irregular and too frequently fail altogether. (See Chap. XL, Industrial Combination.)

In determining the capitalization for speculative corporations, to be organized to exploit mines, inventions and other uncertain undertakings, the same liberal spirit prevails, the promoters estimating future earning powers on the basis of their expectations, and then capitalizing these anticipations. In some few cases, such enterprises succeed and dividends are paid up to the promoter's brightest hopes. These few and exceptional instances then become an alleged justification for the over-capitalization of all similar undertakings.

No safe rules can be formulated for the capitalization of these uncertain enterprises. Usually their stock must be sold at a tremendous discount from face value. This calls for a proportionately large over-capitalization to which it is not possible to apply the ordinary principles of business. Caveat emptor.

§ 38. Capitalization of Good-Will.

In the incorporation of any going concern, or of any combination or re-organization of going concerns, good-will is an asset of much importance and is, as a matter of

course, included among the other assets to be capitalized. This practice is entirely legitimate as the good-will stands for the difference between a live business and the property value of the stock, equipments and other items which make up its implements of trade. As a matter of fact, the good-will is not infrequently the most valuable asset of the concern, even where other assets are of considerable worth.

On account of the intangible nature of good-will, its correct appraisement is often a matter of very considerable difficulty. Its value varies with local conditions and is, at the best, almost entirely a matter of business judgment. Because of this difficulty of accurate valuation, good-will is a favorite device for inflating purposes, and frequently affords a basis for unjustifiable stock watering.

In the ordinary mercantile incorporation good-will is often included without specific recognition. A lump sum is put upon the business as a whole and the corporation capitalized at the figure so obtained. At other times a separation is effected between the property assets and the valuable and intangible asset, good-will. Where this is done, common stock is frequently issued to the appraised value of the good-will, while the cash and accounts, stock, machinery, realty and other property assets are provided for by an issue of preferred stock, the two issues making up the total capitalization of the corporation.

In this case the preferred stock represents the tangible assets, and its preference dividend is in the nature of a high interest on the actual value of this property. In the event of the dissolution or liquidation of the corporation, this preferred stock is frequently paid out or redeemed before the common stock receives anything. (See Chap. VIII, Preferred Stock.)

The common stock, on the other hand, representing the intangible assets—the good-will and earning capacity of the business—receives no dividend of any kind until all other obligations have been paid and then only out of surplus profits. (See § 250.)

§ 39. Form of Capitalization.

After deciding upon the capitalization of an enterprise, a further question arises as to the form of this capitalization. The simplest plan is to have only common stock, but at times there are material advantages in the use of preferred stock.

Preferred stock occupies a position between common stock and the bond. It is a safer form of investment than common stock, but it carries no rights of foreclosure. It takes precedence of common stock as to payment of dividends and frequently as to its ultimate redemption, but its dividend is not payable unless earned. Its dividend is fixed and it does not as a rule participate in excess profits, but its rate is usually much higher than the interest rate of a bond. Where preferred stock can be used to raise money it is regarded as a much more satisfactory means than an issue of bonds. (See Chap. VIII, Preferred Stock.)

§ 40. Bond Issues.

Where a corporation has real property or invests in property having a tangible value, it is often of advantage to issue bonds in place of some portion of the stock capitalization. An enterprise requiring $150,000 in actual value might instead of capitalizing for that amount, incorporate for but $100,000, and then issue bonds for the additional $50,000.

The interest to be paid on these bonds would be less than the dividends a prosperous business would pay upon the same amount of stock and the difference represents a profit for the stock actually issued. Against this is the fact that the interest must be paid whether profits justify it or not, as also the further fact that if interest is not paid, foreclosure proceedings will probably bring the corporation to an untimely termination or reorganization. In such case the proceedings are usually disastrous and most of the assets are likely to be absorbed in settling the claims of the bondholders. For these reasons the issuing of bonds is not safe unless the corporation is sound and of quick earning powers. If there is any doubt on these points,

preferred stock, the security next to bonds in safety and desirability, is the more prudent method of raising money.

§ 41. Financial Exigencies.

If an enterprise is speculative in its character, and direct profits are expected from its financing, or if promotion payments are added to the load under which the new corporation is expected to stagger to success, the conditions do not tend to conservative capitalization. In such cases the immediate financial necessities take precedence of almost everything else, and the capitalization is shaped to that end. Profits for owners and promoters, bonus stock, commissions, advertising and the general expenses of financing are included until, finally, the actual business necessities of the corporation represent but a fraction of the total capitalization, and the final arrangement at times comes dangerously close to being a fraud upon the investing public.

It is unfortunate that the capitalization of a corporation should be influenced by considerations such as these. At times, however, an enterprise will be of such a purely speculative nature that, with all honesty of purpose, it would be impossible to finance it on any conservative basis. Concessions to the necessities of the situation are then imperative, divergencies from the ideal corporate arrangements cannot be avoided, and the best that can be done is to reduce them to the minimum. In such cases, the real interests of the corporation—which are the successful inauguration and prosecution of its business and the production of profits for its stockholders—should be kept closely in view, and only such concessions made as are absolutely essential to successful financing.

CHAPTER VII.

THE STOCK SYSTEM.

§ 42. Capital Stock.

The capital stock or capitalization of a corporation is the maximum amount of stock it may issue under the provisions of its charter. This may bear some direct relation to the actual property values, or "capital" possessed by the corporation—from which it is to be absolutely distinguished—or may be far above or below this real capital. (See § 46.) The stock capitalization may be based on the actual cash value of the corporate property, or on the amount required for the development of the undertaking, or on the earning power of the corporate business, or on the speculative basis of what these earning powers may be when the business is developed, or on some combination of these factors.

The capital stock of a corporation is fixed by its charter and can usually be increased or diminished only by amendment of that instrument. In some states, however, charters are issued empowering the corporation itself, within certain limits, to determine the amount of its capitalization.

The capital stock of a corporation may be issued in part or in whole and its total authorized amount bears no necessary relation to the amount of stock sold, subscribed or outstanding. For instance, a corporation with a capital stock of $100,000 might have issued one-half of this amount, the remainder being reserved for subsequent use. The outstanding stock would then be $50,000, but its capital stock would still be $100,000, unless changed by amendment of the charter, or other statutory method.

In this connection it should be noted that under the common law, a corporation was required to have its entire

capital stock subscribed before beginning business. Until this was done it could not enforce the subscriptions to its stock. Now, however, in most states the stringency of this rule has by statute enactments been greatly relaxed. Some minimum amount, fixed by statute and usually much smaller than the total capitalization, may be designated by the charter as the amount with which the corporation will begin business, and so soon as this amount has been subscribed, the corporation can enforce subscriptions to its stock and may begin its operations. In a few states a further proportion of the capital stock must be paid in within a specified time, as in New York, where a corporation must have at least one-half its total capitalization paid up within one year from the date of incorporation.

§ 43. Shares.

For the sake of accuracy and convenience in representing the interests of the various stockholders in the capitalization, and in the corporate enterprise and property behind it, capital stock is divided into shares which are almost invariably, though not necessarily, of equal value, and together make up the whole capitalization. Unless restricted by statute these shares may be of any desired face value, though the greater portion of the issued stock of this country is in the form of $100 shares. Mining stocks are often issued in shares of the face value of $1, this being done with a view to more impressive offerings, and to the reception of smaller subscriptions than could well be taken with larger shares. In any enterprise to be financed by popular subscription, to have a small share value is considered good policy, $10 being the figure usually selected. Where the holders of stock are few in number and it is desirable to render the sale or other disposition of the stock difficult or other reasons make such course advisable, the face value of the shares—where not prohibited by statute—is sometimes placed at $500 or more. The shares

of the Carnegie Company were $1,000 each, but the United States Steel Corporation placed its shares at $100 each in order that they might be sold to the investing public.

Unless there is some valid reason to the contrary, the generally recognized share value of $100 is to be preferred and selected.

§ 44. Certificates of Stock.

The certificate of stock is merely a convenient evidence of the ownership of corporate shares, and its loss or destruction does not affect such ownership in any way. The loss of the certificate may embarrass the stockholder on occasion, just as the loss of a deed to real estate, or bill of sale to other property might be embarrassing, but he could still collect his dividends, attend and vote at stockholders' meetings and generally perform his functions as a stockholder just as he did before the loss of his certificate. If he wished to sell or otherwise transfer his interest in the corporation, his certificate would probably have to be replaced before the purchaser or transferee would consent to take over the stock. Usually the corporate by-laws provide for the issue of a new certificate in case of loss or destruction of one already issued. The matter is, however, troublesome, at the best, generally necessitating the giving of a bond or other guarantee to the corporation, and the loss of certificates is to be avoided if possible. (See By-Law provisions, "Lost Certificates," in Forms 9 and 10.)

It is to be noted that the certificate of stock is purely a matter of form and convenience, that the ownership of stock may, and in most corporations does exist, before any certificates are issued, and that it would be entirely possible to conduct a corporation—with the consent of its stockholders—without the issue of certificates at all, the stock books of the corporation then being the sole evidence of stock ownership.

Stockholders are, however, entitled to certificates evidencing the stock owned by them and can force the issue of such certificates if withheld. This right must, however, be exercised within proper limits. Stockholders are not thereby authorized to make nuisances of themselves and harass the secretary by unreasonable exactions such as excessive transfers, or demands for large numbers of small certificates, or for issues of fractional parts of a share. To curb the tendency in this direction, the secretary is sometimes empowered by the by-laws to charge a small fee for each certificate issued by him. This is legally permissible and is usually sufficient. (Giesen *vs.* London & Northwest Mortgage Co., 102 Fed. Rep. 584, 1900.)

§ 45. Unissued Stock.

A corporation is empowered by its charter to issue stock up to the full amount of its authorized capital stock. At the time the charter is allowed all this stock is unissued. Thereafter it may be issued, in whole or in part, at the discretion of the corporation or as required by its operations. The unissued stock, no matter whether it be the whole capital stock, or only a reserved portion thereof, represents nothing whatever beyond the potential right of issue. It has no intrinsic value. It is merely the right—granted by the state—to issue stock up to the prescribed amount.

This being so, the unissued stock cannot in any way be regarded as an asset of the corporation. If sold it brings in cash, property or other values that have a greater or less intrinsic worth, but the outgoing stock carries with it an interest in the corporate property that should equal the value received for such stock. The general corporate property has been increased, but the ownership thereof has likewise been increased in the same proportion. In bookkeeping parlance, the increase of assets and liabilities is exactly equal. The unissued stock therefore represents nothing more than the right to admit new members, or stockholders, into the corporation, upon payment

of the proper *quid pro quo*. To regard it as an asset would be as illogical as to consider the right to admit new partners in a firm an asset of the partnership. (See § 64.)

§ 46. Issued Stock.

Stock is always supposed to be issued at its face or par value for cash or other actual values. At the time of organization, therefore, the face value of the stock issued—if full paid—would, theoretically, equal the actual value of the corporate assets. Even if this be true in fact, these values may, and generally do, vary widely thereafter. If the corporation is successful, its assets may increase far beyond the nominal value of its issued stock, while if unsuccessful, these assets will probably fall far below the total face value of the issued stock. That is, the value of such stocks as shown by the books of the corporation will be far above or below the par value. The selling price may, and, depending largely upon the rate of dividends maintained and the general desirability of the stock, probably will be at a still different figure.

A corporation may by purchase, gift or otherwise regain its issued stock. Such stock coming back into the possession of the corporation is not thereby retired, or classed as unissued stock, but is designated as treasury stock, may be issued when desirable and is usually regarded as an asset. (See Chap. X, Treasury Stock.)

§ 47. Full-Paid Stock.

In the absence of statute laws to the contrary, stock may be issued on any basis that the directors—with the assent of the stockholders—deem best. That is it may be issued for its full face value in money or property, or it may be issued for only a portion of its face value, or may be issued on a promise to pay, or on partial payments, or on no payment at all as a free gift. If, however, it is not paid for at its full face value in money, property or services—where payment is allowed by services—it is not full-paid stock, and therefore carries a lia-

bility for the amount still unpaid. (See Chap. IX, Full-Paid Stock.)

The term " watered stock " is merely a convenient designation for stock issued in excess of the values behind it. (See §§ 60 and 61.)

§ 48. Common and Preferred Stock.

Preferred stock is that to which some preference has been given over other stock of the same corporation as to participation in profits, and often in assets in case of liquidation. If there is no distinction in regard to these two features the stock of a corporation is all common stock.

Different preferred stocks may be issued by the same corporation in any desired variety of preference as to dividends and redemption or liquidation rights. These would be distinguished from each other as first, second and third preferred stock, or by other designations descriptive of the peculiar status of each stock. The lowest, or non-preferred, stock would be common stock.

§ 49. Other Classifications.

As stated, the capital stock of a corporation may be divided into common and preferred stock on the basis of its relation to the corporate profits or property. Stock may also be classified in other ways. Most of these other classifications relate to the voting right. The simplest is a division of the stock into two classes, one class voting, the other not exercising this right. For instance in the incorporation of a partnership where one or more take the active management, others merely supplying the capital, the active partners might have their interests represented by voting stock and the interest of the silent partners represented by non-voting stock. (See Chap. XXXVIII, Incorporating a Partnership.)

Other classifications are possible in considerable variety, and, generally, it may be said that any desired classification is allowable that is not repugnant to equity, to the common law,

or to the statute law of the state under which the corporation is organized. On the other hand it may be said that such classifications, unless clearly demanded by the conditions, are not to be recommended. They may work unexpected hardships, are at times very uncertain in their actions, and introduce undesirable complexities into the corporate mechanism.

Classifications of stock may be authorized either by charter or by-law provisions. As a matter of prudence they should be incorporated in the charter where possible. The specifications relating to any class of stock—except unmodified common stock—should be printed in full on the face of each certificate by which such stock is represented. (See §§ 98, 232, 239 and 252.)

CHAPTER VIII.

PREFERRED STOCK.

§ 50. General.

Preferred stock is that which has some preference as to dividends or assets over other stock of the same corporation. This preference is usually given to make such stock safer or more attractive, though at times its purpose is to limit dividends or gain some other desired end.

The use of preferred stock is general. It is perhaps most commonly employed where money is to be raised for the development or operation of a corporate enterprise. For this purpose it may be made to offer greater safety both as to principal and dividends than common stock, while it does not carry the dangerous foreclosure privilege of the bond.

When a business is incorporated, preferred stock is frequently issued to represent or pay for the actual property assets, the good-will and other intangible assets being represented by an issue of common stock. When a partnership is incorporated, the excess investment of one partner is very often represented or satisfied by an issue of non-voting preferred stock, while the interests of a silent partner may be conveniently cared for by the same means. Where an invention or other property is taken over and payment made in stock, the transferrer, on account of its greater safety, will frequently demand a portion or the whole of his price in preferred stock, and, generally, the device will be found most useful in effecting the adjustments and allowances so frequently necessary in incorporating.

Usually preferred stock is created by charter provision, the preferences and restrictions being set forth at length. In many

states it may be authorized by proper by-law provisions, but it is always better and safer to provide for it in the charter.

After incorporation, unless otherwise provided by statute, the assent of every stockholder is required for the issue of preferred stock. This is reasonable, as the value of the common stock may be depreciated by such an issue. In some states, however, the statutes allow preferred stock to be issued after the incorporation of the enterprise when authorized by a two-thirds vote of all the outstanding stock.

Preferred stock is issued in many different forms and with many different classifications, privileges and restrictions. The possible range is wide and includes almost any desired attribute not contrary to law or public policy. All the conditions of any particular issue should appear upon the face of the certificate by which such preferred stock is represented. If the specifications are too voluminous for this, the fact that the certificate represents preferred stock should appear plainly on its face, together with a reference to the provisions of the charter by which such stock is authorized. Such notice is sufficient to put any intending purchaser on his guard, and if he purchases the stock he cannot afterward assert ignorance of its conditions as a basis for litigation or claims against the corporation.

Unless specifically prohibited therefrom by proper provision in the charter, by-laws or other authorization under which such stock is issued, preferred stock carries the right to vote, and the right to participate in dividends beyond the preferential dividend after the common stock has received a dividend equal thereto. That is in any year, if the preferred dividend is paid and the common stock has received a dividend equal in amount to this preferential dividend, then any further dividends belong to and must be paid to all the stock, common and preferred alike. Preferred stock would have no preference over common stock in the distribution of assets in case of liquidation or dissolution, unless such preference were specifically given by statute or set forth in the authorizing provisions.

Preferred stock differs from a bond issue in the very mate-

rial point that interest on bonds must be paid when due and can be enforced by a foreclosure suit, while dividends on preferred stock are only payable from net profits, and if profits are not made, are not due and therefore cannot be collected. Also, bonds must be paid on maturity, while preferred stock has no fixed due date. For these reasons the issue of preferred stock is much safer for the ordinary corporation than the issue of bonds. Bondholders are creditors of the company. The holders of preferred stock are not creditors of the company, have no claim against the company except for dividends when declared, and have no rights, save for their preferences, superior to those of the common stockholders. Preferred stock is much favored in the formation of industrial trusts. (See Chap. XL, Industrial Combination.)

In many states there are statutory provisions relating to preferred stock which must be consulted when the subject is under consideration, these statute laws taking precedence of the general or common law herein set forth. Statutory authorization for the issue of preferred stock is not necessary. (See Kent *vs.* Quicksilver Mining Co., 78 N. Y., 159, 1879.)

§ 51. Preference as to Dividends.

The following extract gives a common form of charter provision authorizing the issue of a simple preferred stock:

> "Of said capital stock, five hundred shares of the par value of fifty thousand dollars shall be preferred stock, entitled to receive from the net earnings of the company an annual dividend of six per cent. before any dividends are paid upon the common stock."

The holder of a preferred stock, such as provided in the paragraph quoted, would have the same voting right as the holder of common stock, his dividends, although this is not specifically stated in the creating clause, would be cumulative and he would participate in any general dividends in excess of the preferential dividend already received. In case of liquidation of the corporation he would in most states have no claim to preference in the distribution of assets.

Preference as to dividends may be as to amount, as in the creating clause given, or as to profits from certain sources, as where a preferred stock is to receive all the profits of a certain plant or a particular branch of the business.

The usual rate of dividend on preferred stock ranges from five to seven per cent., though but few reliable stocks bear this latter rate. In some states the rate is limited to a maximum of eight per cent.

§ 52. Preference as to Assets.

Unless otherwise specifically provided, preferred stock participates in any distribution of assets upon the liquidation of the corporate property just as common stock does but has no preference of any kind. Some preference in this respect is usual, the customary arrangement requiring the payment of the par value of preferred stock with all arrearages of dividends before anything is paid upon the common stock. In New Jersey such provision would not be necessary as the preferred stock carries this right under the statute law, but even there it would be better incorporated in the charter to prevent any mistake or misapprehension as to the status of the stock.

§ 53. Cumulative Dividends.

Preferred stock may be cumulative or non-cumulative. If the former, its dividends are not payable if not earned, but when profits are earned its unpaid dividends, past or present, are a first charge against such profits, and must be paid before the common stock receives anything. If preferred stock is non-cumulative, a passed dividend is lost and is not a charge against the company in any way. Usually a non-cumulative preferred stock is not a desirable holding. Its existence is a standing inducement to the improper passing of dividends. The courts sometimes interfere on behalf of the holders of non-cumulative stock

where profits have been made and the directors unjustly refuse to pay dividends.

It is to be noted that if the preferential dividend is to be non-cumulative, this fact must be clearly expressed in the charter provisions by which the stock is authorized. Where not so expressed the courts have held the preferential dividends to be cumulative and payable in full out of the first profits before anything is received by the common stock. (See Boardman *vs.* Lake Shore etc., R. R., 84 N. Y. 157, 1881.) The cumulative feature of preferred stock is, however, for the sake of security and definiteness usually covered by express provision.

Preferred stock bearing cumulative dividends is sometimes called "guaranteed stock" but the term is not well applied, being used with greater propriety to describe stock upon which the dividends are guaranteed by some other corporation. This latter form of stock is a not uncommon expedient in arranging the terms of railroad combinations and the employment of the term "guaranteed stock" in that connection is the more customary as well as the better use.

§ 54. Participation in General Dividends.

As already stated, unless otherwise expressly provided, preferred stock participates equally with the common stock in all dividends after both common and preferred have received an equal dividend. That is, if the preferred stock has received its preferential dividend of, say six per cent. together with any cumulated arrearages, it participates no further in dividends until six per cent. has been paid upon the common stock as well, but thereafter both classes of stock stand upon exactly the same basis as to any further dividends declared during that year. If such further participation on the part of the preferred stock is not desired, it must be expressly denied.

Such participation privilege beyond the preferential

dividend is not common. It is sometimes employed to advantage in the adjustment of interests among incorporating parties, but is usually only found where the stock must be made attractive above the common, as in a speculative corporation where the risks are extra-hazardous, or under other conditions necessitating unusual inducements to investors.

The same ends are sometimes attained by the use of preferred stock limited to its preferential dividend, but accompanied by a common stock bonus of equal amount. This plan is, however, much less advantageous than the use of participating preferred stock, as it involves (1) the payment of additional dividends on stock equal in amount to the preferred stock, (2) an additional voting right in the management, (3) in event of liquidation a double claim against the assets. That is one share of participating, non-voting, six per cent. preferred stock of the par value of $100 would, if eight per cent. dividends were paid annually, receive $8 dividends yearly, would not participate in the management at all, and, on liquidation, would have only its own claim against the assets. If instead the preferred stock were non-participating, but were accompanied by a bonus of one share of common stock, also of the par value of $100, the two would receive $14 in dividends yearly, would have one vote in the management, and, on liquidation would have a double claim against the assets.

Where a participating preferred stock is issued, to avoid misunderstanding, a distinct provision in the authorization should cover such participation.

§ 55. Redemption Right.

Preferred stock is often issued with the proviso that after a certain period, and after specified notice, the corporation shall have the right to buy in, or redeem, its outstanding preferred stock at some previously designated price.

The New Jersey statutes give the right to provide for re-

demption of preferred stock at any time after three years from the date of issue. In New York there is no statutory provision as to such redemption, but in the absence of any prohibition the redemption of preferred stock under suitable conditions would seem to be entirely within the power of the corporation, and this is true in any state. (See Citation in § 98.)

It is to be noted, however, that under no circumstances would the corporation have the right to redeem preferred stock when by so doing it would impair its capital stock or affect the rights of creditors. For this reason such redemption should not be made mandatory, as the corporation might then later find itself under contract obligation to do an illegal act.

The redemption right is sometimes of considerable importance, and, if it can be done without injury to the sale of the preferred stock, should be retained. Dividend rates on preferred stock are usually much higher than interest rates on borrowed money, and, if the corporation accumulates surplus profits, the preferred stock may be redeemed and its high preferred dividends terminated, with much advantage. Usually, if the period prior to the operation of the redemption right is reasonably long, and the redemption premium is attractive, this privilege may be provided without detriment to the salability of the stock affected.

The redemption price of preferred stock varies with the conditions. Always, as a pre-requisite, the payment of any accrued dividends is involved. Frequently the price is fixed at the par value of the stock plus one year's dividend. At other times it is arbitrarily placed at a figure thought attractive, or fair, as 105, 110, or even more under some circumstances. Occasionally the holders of the preferred stock will be given the option of exchanging their stock for common stock instead of taking the redemption price.

Preferred stock when redeemed is no longer a claim against the dividends or assets of the company. It is, however, still a part of the capitalization of the company, and might, with the assent of the stockholders, be again reissued.

§ 56. Voting Rights.

Unless otherwise expressly provided, preferred stockholders have exactly the same right to participate in corporate meetings and to vote upon their stock as do the holders of common stock. Usually, however, this voting right and the right to participate in stockholders' meetings is denied the preferred stock, the power of management being reserved to the common stock. In such case the provisions by which the preferred stock is created should state the fact of its non-voting character with clearness, and this fact should also appear plainly upon the face of the certificate by which such preferred stock is represented. Under such circumstances the preferred stockholders have no more to do with the management of the corporation than would its bondholders.

A variation on this plan of absolute non-representation is to provide that the holders of preferred stock shall not vote so long as the preferential dividends are paid with reasonable regularity, but that if such preferential dividends shall at any time fail, for say two consecutive years, then the holders of preferred stock shall thereafter have the right to vote in all respects as do the holders of common stock.

This plan has the appearance of equity. If those in charge of the corporation cannot manage the corporate business so as to pay dividends on even the preferred stock, it would seem but reasonable that the holders of preferred stock, who suffer by this mismanagement, should be allowed a voice in its control. If interest is not paid on a bond issue, foreclosure results and the bondholders not infrequently buy in and conduct the business. Giving the preferred stock a conditional voice in the management is a far milder application of the same principle.

§ 57. Convertible Stock.

In New Jersey by a statutory enactment of recent date, corporations answering to certain descriptive conditions are allowed to redeem their preferred stock, the holders consenting, with bonds. By a singular coincidence, the United States Steel

Corporation was found to be within the descriptive prescriptions, and, with the consent of two-thirds of its outstanding voting stock, it offered the holders of its seven per cent. preferred stock the privilege of exchanging such stock for five per cent. bonds. The exchange was entirely optional with the holders of the preferred stock, but the measure aroused bitter opposition and litigation. The exchange was finally upheld.

In the absence of permitting statutory provisions, any such exchange or arrangement for such exchange would be illegal.

§ 58. Founders' Shares.

In England, founders' shares, a kind of preferred stock which may be described as a privileged deferred stock, are frequently issued. To illustrate, a corporation capitalized at $300,000, with $100,000 of this as preferred stock and $200,000 as common stock, might have $25,000 of common stock set aside as founders' shares, with perhaps dividend rights equal to all the other common stock. That is, under the supposed arrangement, after the preferred stock had received its dividend, any further dividends would be divided into two equal parts, one of which would go to the ordinary common stock; the other to the founders' shares. In other words, the $25,000 of founders' shares would equal $175,000 of the ordinary shares as far as participation in dividends was concerned.

Under this arrangement the founders' shares might have a very high value, many times in excess of that of the common stock. Where employed, such shares are usually reserved as an emolument for the promoters of the enterprise, or as compensation to men of eminence or financial repute for the use of their names.

It is supposed that under the New Jersey laws, and under the laws of some other states, these founders' shares might be legally issued. Some few companies have been organized upon this basis, but it does not appear that the subject has ever come up for adjudication in this country, and it is not certain what view might be taken of the matter by the courts. Probably,

if accomplished by proper charter provisions, and with the full knowledge of the stockholders generally, and with all due publicity, the arrangement would stand. As everything to be secured by the use of the founders' shares can, however, be accomplished by the skilful, but recognized and adjudicated use of common and preferred stock, it would hardly seem wise to venture on ground that is, at the best, experimental and of doubtful utility.

CHAPTER IX.

FULL-PAID STOCK.

§ 59. General.

Under the common law stock might be issued at any price deemed proper by the parties to the transaction, and, in the absence of fraud, such sale was valid and final. Now, however, subscribers to stock on its original issue must pay its par, or nominal value, under penalty of possible liability to the corporation or its creditors for the amount necessary to make up the full face value of any stock issued for less.

In most states full-paid stock carries no liability, either in favor of the issuing corporation, or of the creditors of that corporation. (See § 62.)

§ 60. Watered Stock.

Stock issued as full-paid when the corporation has in fact received nothing for such stock, or but a portion of its par value, is commonly termed "watered stock." It is also sometimes called "fictitiously paid stock" and many states explicitly prohibit its issuance by statute. Watered stock may be created by the issue of stock as a stock dividend without sufficient increase of the corporate property to support additional stock, by its issuance as a bonus with preferred stock or bonds, or, as is the method in the great majority of cases, by its issuance for property or services at an over-valuation.

The most obvious form of watered stock is that occasionally issued by the large public utility corporations as a stock dividend. In such cases there is usually no

pretense of any increased value in the property behind the stock and its issue is justified only by the ability of that property to pay dividends upon the increased capitalization. If the corporation were forced into liquidation, the stock would receive only a fraction of its face value. Such a stock dividend must be distinguished from a stock dividend paid in lieu of cash dividends of equal amount, where the reserved cash is added to the working capital of the company, and the issued stock therefor represents actually increased values, capable of realization in event of the liquidation of the company.

The most common form of watered stock is that issued in the purchase of property at an over-valuation. Such stock is nominally full-paid and in some cases by the subsequent prosperity of the corporation, the anticipations of its promoters are realized and the stock is removed from the category of watered stock. In the majority of cases, however, the corporations do not meet the expectations of their organizers, and the issued stock is left with but little support. In such case, if the undertaking is of sufficient value in actual property or in possible profits to justify the step, a re-organization takes place, the capital stock is greatly reduced, thereby "squeezing the water out of it," and the corporation is placed on a decreased, but usually, much sounder basis.

§ 61. Legal Status of Watered Stock.

Stock issued at less than its full face value without agreement between the parties thereto as to the nature of such stock, is partly-paid stock, and the purchaser is liable to the corporation, or, in event of the insolvency of the corporation to its creditors for the amount necessary to make up the full face value of such stock. If, however, it is agreed between the purchaser and the corporation that the price paid shall be in full settlement of the claims of the corporation against such stock, then as between the parties

the stock is full-paid, and, in the absence of fraud, the holder is under no liability to the corporation. (Scovill *vs.* Thayer, 105 U. S., 143, 1881.)

This is true as to the corporation but not as to its subsequent creditors, unless by agreement of these latter, and, in event of the insolvency of the corporation, these creditors might proceed against the original purchasers of any watered or partly-paid stock so long as such stock remained in their hands, and collect from them the amount necessary to render their stock full-paid.

This possible liability would follow the unpaid stock into the hands of transferees purchasing such stock with a knowledge of its character, but would not follow it into the hands of an innocent purchaser for value. (See § 62.)

It is to be noted that the general doctrine as stated requires modification in those cases where the board of directors of a corporation have issued stock for property or services, in good faith and without fraud, and later developments prove the consideration to have been—or to be—worth less than the face value of the stock. In such event, in most states of the Union, the courts refuse to hold the recipients of the stock liable on the ground of failure or insufficiency of the consideration. (See Chap. XXXII, Issuance of Stock for Property.)

§ 62. Legal Status of Full-Paid Stock.

Full-paid stock carries no liability of any kind, either to the corporation or its creditors, save in those few states where by statute special liabilities have been created. This freedom from liability, no matter what the vicissitudes of the corporation, gives to stock its desirability as a form of investment. As this feature pertains only to full-paid stock, it is a great object in the organization of a new corporation to render its stock full-paid.

Where stock is issued at par for cash, which with financial institutions is usually a matter of statutory obliga-

tion, or for cash and substantial property to the actual face value of the stock as in the case of some solid business corporations, the question does not arise. The ordinary corporation, however, cannot as a rule sell its stock at par, particularly when it is organized for the development of some new or speculative enterprise. To issue such stock direct for less than par would leave the purchasers—if purchasers could be found—liable for the difference. Various expedients are then utilized to render this stock full-paid before it is sold to the actual purchasers for cash, and the methods adopted to secure this end have given rise to most, if not all, the litigation relating to the full payment of stock. (See Chap. XXXII, Issuance of Stock for Property; also Chap. X, Treasury Stock.)

§ 63. Certificates for Full-Paid Stock.

When stock is full-paid the certificates by which it is represented usually bear upon their face the words "Full-Paid and Non-Assessable." There is no legal requirement that the certificates shall be so inscribed, but if they were not the purchasers would—and very properly—be suspicious of the stock. The direct and legitimate inference from the omission would be that such stock was not full-paid and non-assessable and might carry latent liabilities.

On the other hand, where certificates are marked "Full-Paid and Non-Assessable," such stock may be bought with full confidence that its purchase involves no unknown liabilities. Even should it later prove to have been but partly paid, or not paid at all, the innocent purchaser for value could not be held liable on that account. He purchased on the faith of the unquestioned statement on the stock certificate that such stock was full-paid, and, as far as he is concerned, the stock will be held to bear that character. (Young *vs.* Erie Iron Co., 65 Mich., 111, 1887; Rood *vs.* Whorton, 67 Fed. Rep., 434, 1895; Sprague *vs.* National Bank of America, 172 Ill., 142, 1898.)

The word " Non-Assessable " merely indicates that the corporation has either received full payment of the stock in question, or otherwise that it has relinquished any claim it might have on such stock for further payments or assessments of any kind. Full-paid stock is non-assessable under any circumstances except in California and some few other states where the statutes permit the corporation to levy assessments.

In some few states certificates representing stock issued for property must bear the legend " Issued for Property " or some equivalent statement. Elsewhere, this is neither necessary nor desirable. Such stock is of no different nature or legal status from any other stock, and to inscribe it in the manner indicated conveys the impression that some difference actually exists. (See Chap. XXXII, Issuance of Stock for Property.)

CHAPTER X.

TREASURY STOCK.

§ 64. Definition.

The term "Treasury Stock" is employed very loosely by business men and accountants to describe unissued stock. The better use of the expression is to designate the "Issued and outstanding stock of the company that has been donated to or purchased by the corporation and which is held subject to disposal by the directors." Such stock is properly treasury stock, is the property of the company, and would be entered as an asset on its books.

To style unissued stock "treasury stock" is a misnomer. Unissued stock is merely the privilege of creating a liability. It is not in any sense of the word an asset. For $20 the State of Arizona will charter a corporation and authorize it to issue stock to the face value of $25,000,000 or more. Such a company on organization would have an over-plentiful supply of unissued stock, but no assets whatever. The absurdity of regarding its unissued stock as an asset is obvious. (See § 45.)

Stock that has been once legally issued for full value, however, is of a very different nature. It is then full-paid stock and represents a certain interest in the corporate property. If any of it comes back into the possession of the company it is still "full-paid stock," and is then with some logical correctness considered an asset. Such stock is properly classified as treasury stock and may be sold below par to raise funds for the operations of the company, may be given away as a bonus with preferred stock or bonds, or be otherwise used without involving the recipient in any liability to creditors of the corporation.

§ 65. Origin.

If a corporation were organized upon a strictly cash basis, each subscriber paying the par value for his stock, it would have no treasury stock at the time of organization. Later should a portion of this issued stock come back into the possession of the company in settlement of some debt or through other negotiation, such returned stock would be treasury stock and from the bookkeeping standpoint an asset of the company.

When, however, as is so frequently the case, a corporation is organized to exploit some mine, invention or other enterprise, or to make a combination of existing corporations, it would under the usual plan, issue all or a large portion of its stock in payment for the property assigned to the corporation. This stock is thereby rendered full-paid. Then by agreement, or by understanding, the recipient of this stock assigns back to the corporation, or to some trustee for the corporation, a proportion of this full-paid stock to be used for company purposes. This would be the treasury stock of the company and in the present day it is thus as a general rule treasury stock is obtained. Such stock is usually a clear donation, the disposition to be made of the stock being sometimes prescribed, but generally left to the discretion of the board of directors upon whom its disposal devolves.

§ 66. Transfers to Corporation.

When stock is thus donated or otherwise transferred to the corporation, the certificates might be assigned to the "..... .....Company" or to "Treasurer of the..... Company." Such stock should not be assigned to the treasurer by name, that is to "John Wilson, Treasurer," as at a subsequent election the position of treasurer may be filled by some other person, and the too definite indorsement may then cause trouble.

A plan that is sometimes pursued when stock is thus turned over for the benefit of the company is to assign it to trustees,

to hold and sell such stock for the benefit of the company, either at their own discretion, or under the superintendence of the directors, the funds so received being paid over to the treasurer of the corporation. This plan relieves the corporation of all responsibility as to the details of the matter, and, the transaction not appearing on the company's books until the money from the sale of the stock is received, the bookkeeper is relieved from some perplexity as to his ledger account with treasury stock.

When certificates representing treasury stock are received by the corporation, they should bear the proper indorsements, and would then usually be turned over to the secretary. This official would enter the transfer in the stock book, cancel the old certificates and return them to the stock certificate book, and, if desired, issue new certificates in the name of the corporation or of the official by whom the stock is to be held. It is to be noted that new certificates need not necessarily be issued at all until sales of treasury stock are made, when the certificates representing stock sold might be issued directly to the purchasing party. In such case, until the time of sale, the stock book, in connection with the canceled certificates of the stock certificate book, would be the sole but sufficient evidence of the status and ownership of such treasury stock.

§ 67. Transfers from Corporation.

When treasury stock is sold the formalities are simple. The sale being duly authorized by the directors, the treasurer would, if the stock were held by him and the original certificates had been canceled without reissue, merely give the purchaser an order for the required certificates, or instruct the secretary in writing to issue such new certificates. If the original had been canceled and new certificates issued to the treasurer, this latter official would merely assign one of his certificates, if of the right denomination. If otherwise he would have one broken up, the proper number of shares being issued therefrom to the new pur-

chaser and the unsold remainder being issued to the treasurer. If the certificates had been held in the name of the corporation, the treasurer or such other official or officials as were designated by the board would make the proper assignments.

§ 68. Legal Status of Treasury Stock.

When its own stock is held by the corporation, or by trustees, or by its officers, for the corporation, such stock, so long as it is so held, is inert and can neither vote nor participate in dividends. Should the stock be voted, such action would be illegal and any action or election decided by the vote of treasury stock would also be illegal and might be set aside. If dividends should be declared and paid upon such stock, the action would be unauthorized and would also be meaningless as the money so paid would come directly back into the treasury of the corporation.

§ 69. Stock of other Corporations held in Treasury.

It is to be noted that the comments of the preceding section do not in any way apply to stock of other corporations which may be owned and held in the treasury of any particular corporation. Such stock would be personal property, and liable to taxation as such, and would maintain all its corporate rights and privileges in full vigor. It would participate to the full in any dividends declared by the corporation from which it issued, and would be entitled to full representation and voting rights at any stockholders' meeting of that corporation. Such stock would be voted, either in person or by proxy, by the trustee or official in whose name it was held, or if held in the name of the corporation by such person as was formally designated thereto by the corporation. Such vote would be cast under the general instructions of the board of directors, but, unless matters of much importance were to be considered, the details of his representation and the actual vote would

usually be left to the discretion of the person who represented the corporation.

It is to be noted, however, that a corporation cannot legally hold the stock of another corporation, unless specifically authorized by statute as in New Jersey, or by charter provision allowable under the statutes, as in New York. (See Chap. XXXIX, Holding Corporations.)

CHAPTER XI.

STATUS OF STOCKHOLDERS.

§ 70. General.

In the active affairs of the corporation the stockholders occupy a position of minor importance. They own the stock of the corporation, and through that ownership, the corporation itself with all its belongings. Their control of the organization and their management of its affairs is, however, indirect and somewhat removed. The business is theirs and its profits belong to them but its actual management and the general control of the corporation are in the hands of the directors, with whom the stockholders, either individually or collectively, cannot directly interfere.

§ 71. Functions.

The functions of the stockholders are few and simple. They assemble once a year in annual meeting to listen to reports, elect directors and discuss the general affairs of the company. On rare occasions they are assembled for particular action in special meeting. If the charter is to be amended, they are usually required to act. If all the assets of the corporation are to be sold, they are generally called upon to sanction the proceeding. In some states their consent is required to validate corporate mortgages. They would act on any proposed liquidation of the corporation. By charter provisions, their consent may be necessary to other proposed action. One other most important function pertains to the stockholders; the right to make, amend and repeal the by-laws. (See generally Part IV, By-Laws.)

The active connection of the stockholder with his corporations is, under normal conditions, limited to the functions

specified. The further control and direction of the corporate organization and its property and business are left entirely to the directors he has elected.

§ 72. Rights.

As a matter of common or statutory law the stockholder has a right to due notification of all stockholders' meetings, to participate in their proceedings and to vote on all questions submitted thereto, and in the election of directors in the manner and to the extent to which he is entitled by reason of his stockholdings. In case dividends are declared he is entitled to receive his due proportion.

In addition to these rights, he is entitled to the honest and capable management of the corporate business and interests and to the proper disposition of the profits derived therefrom.

Rights of the first class require but little attention from the stockholder beyond due provision as to the manner and details of their observance. His further rights, while broadly secured to him under existing laws, are more immediately and more definitely secured to him by care in the selection of his agents, the corporate directors, and by the proper regulation and restriction of these agents in their management of the corporate affairs, by intelligently drawn by-laws. It may be said in passing that the selection of honest and capable directors is by far the best and most effective means of safeguarding the interests of the stockholders.

§ 73. Powers.

Under ordinary conditions the stockholders have, as a matter of course, full power and freedom in the selection of directors, and, it is to be presumed, will select men of experience and ability in the line of the corporate affairs, and men to whom the direction of these affairs may be safely entrusted.

Beyond this, the stockholders have somewhat broad powers in the restriction and regulation of the directors, through their right to make, amend and repeal the by-laws. Such regula-

tion of the management must, as a general rule, be secured in the inception of the enterprise. Thereafter it is often difficult and at times impossible to secure the passage of the necessary regulations.

§ 74. Liabilities.

The liabilities of stockholders as such are few—usually only to pay the full par value of the stock subscribed for or purchased by them. This liability on unpaid stock may, by agreement of the issuing corporation, be terminated as between the corporation and its stockholders but would still exist as between these stockholders and creditors of the corporation, and, on the insolvency of the corporation, would become immediately effective. (Dickerman *vs.* Northern Trust Co., 176 U. S., 181, 1900; Thompson *vs.* Knight, 74 App. Div., N. Y., 316, 1902.) (See Chap. IX, Full-Paid Stock.)

In some few states additional liabilities have been imposed on stockholders by statutory enactments.

§ 75. Relations to Directors.

If unrestricted by charter or by-law provisions, the directors' control of corporate affairs is almost absolute. They cannot be interfered with or restrained so long as they exercise ordinary care and honesty. Even if they fail in these elementary requirements, the stockholders' remedy is indirect and difficult.

If the directors manage the business in opposition to the wishes of the stockholders, the latter are almost helpless The directors are not amenable to request or resolutions, cannot be removed, and may pursue any policy they deem best short of actual fraud or the grossest mismanagement.

In some cases the stockholders by means of special meetings and the by-laws passed thereat may exercise a certain negative control over the board, but, practically, when unrestricted by charter or by-laws, the directors are independent of the stockholders as to the management of corporate affairs, and any

attention they pay to the wishes of the latter is a matter of courtesy or policy or propriety, not one of obligation.

If the stockholders do not wish to repose such absolute control of the corporate affairs in the board, they may restrict its power to some extent by means of suitable charter and by-law provisions. Such provisions where permitted are best incorporated in the charter. The objection to such provisions in the by-laws is the comparative ease with which they may be changed. By-law provisions are quite as effective so long as they remain in force as similar provisions in the charter.

If a majority of the stockholders are agreed as to what is needed—more particularly in the inception of the enterprise when the first by-laws are being formulated—their power to restrict and regulate the actions and authority of the board is quite extended. It is a power, however, that should be exercised with discretion. If the regulation of the board be carried too far, its freedom of action will be hampered to the injury of the business and it will be difficult to secure capable men to act as directors.

The best guaranty of the proper conduct of the corporate business is the election of honest and capable directors. and if such be secured, their regulation and restriction is a matter of minor importance. As such directors are not always available, and as mistakes as to the character of candidates sometimes occur, it is usually advisable, however, to impose reasonable regulations and restrictions.

Usually the restrictions on the power of the board will be in the direction of limitations of the debt incurring power, restrictions as to salaries to be paid officials, regulations as to payment of dividends and the handling and disposition of the company's finances, and provisions for the regular inspection and auditing of the corporate books and records. (See generally §§ 116, 117, 236, 243.)

The stockholders' regulations might be extended much further than this. The right to elect officers might be reserved by the stockholders, the board might be made amenable to

stockholders' resolutions, and the right to remove directors on occasion might be retained by the stockholders as a means of enforcing compliance with their wishes.

Measures of this kind are extreme and of questionable expediency. In some states they would be of doubtful legality, and in any state they would be liable to introduce unnecessary, and, at times, embarrassing complexities, in the scheme of corporate organization. They are not found in the best-managed and most successful business corporations of the country.

PART III.—THE CHARTER.

CHAPTER XII.

GENERAL CONSIDERATIONS.

§ 76. Nature of Charter.

The foundation of the corporation is a formal written grant or authorization from the state. This instrument was originally known as the charter, but is now usually designated by the statute laws of the various states as the certificate of incorporation, or the articles of association. From a legal standpoint there is no distinction between these different names. As a matter of convenience the term charter is generally employed in the present volume. The charter may be granted by a particular state, or by the general government, as in the case of national banks and certain other corporate organizations.

Formerly every charter was created, or authorized, by a separate legislative act. Such charters, termed special charters, are still granted in some states by act of legislature, but the greater number of corporations are organized under state laws of general application. (See § 82.)

All corporations have certain common law powers, such as the right to sue and be sued under the corporate name, the right to contract and to use the corporate seal. In addition they have any general powers granted by the statutes and the special rights granted by their respective charters, such as the use of their particular name, the right to carry on the special business and to have a certain capital

stock. They also have such incidental powers as are necessary to render these express powers effective. The exercise of any further powers, privileges or limitations would be *ultra vires*, and could only be authorized by proper amendment of the charter.

As the charter is usually a very formal instrument, and the procedure for its amendment is also formal and usually troublesome, it is important that all desired purposes and powers should be stated with clearness and fullness in the original charter application.

The powers and privileges conferred upon a corporation by its charter are only such as are allowable under the laws of the state of incorporation. Ordinarily any provisions of a different tenor would be refused or stricken out of the charter application by the state officials. Occasionally it happens, however, through official ignorance, inadvertence or indifference, that powers and privileges illegal, or not permissible, are passed and apparently granted by the charter of a corporation. Such appearance is deceptive. The corporation is empowered by its charter just so far as that instrument is in accord with the law of the state and no further. The charter is not and cannot be superior to the law, and is absolutely ineffective just so far as it goes beyond.

§ 77. Classification.

Charters are divided into two important classes by the general division of corporations into stock and non-stock, or membership corporations. Charters for membership corporations are much simpler than those for the ordinary stock corporation, and as all that pertains to them is included in the law relating to stock corporations, they are not treated specifically in the present volume.

Beyond this general division, stock corporations and the charters creating them may be divided into three important classes.

First, business corporations organized to conduct an ordinary mining, mercantile, manufacturing or other private business.

Second, public utility corporations, organized to undertake some public function, such as the supply of heat, light, power or water, or the construction or operation of a railway, a telephone or telegraph system.

Third, financial corporations, as banks, trust companies, building associations and insurance companies.

The corporations of each of these classes are created by charters differing from those of the other classes in form and terms, though all conform to the general principles governing charters.

§ 78. Business Corporations.

This term is used to designate corporations organized to conduct those various forms of private business not subject to special regulations and restrictions in the interest of the public. All corporations for mining, manufacturing and mercantile pursuits are included under this head.

Business corporations are, as a rule, chartered in each state under general, uniform laws and forms, have no special privileges, and, when incorporated, are allowed to pursue their corporate ends almost as freely and as simply as would a private individual or firm under the same circumstances. The majority of existing corporations belong to this class and the great mass of corporate law and decisions applies to them primarily. For the other classes of stock corporations there are special laws, special limitations, and, in some cases, special privileges.

§ 79. Public Utility Corporations.

Public utility corporations are those organized for the purpose of securing and operating under some franchise of a public nature which confers upon such corporations rights or privileges which other citizens and private cor-

porations do not enjoy. Usually these franchises carry with them certain rights of way, or condemnation powers to secure such rights granted by the state under its power of eminent domain.

An ordinary private corporation enjoys no exclusive franchise of this nature, and, generally speaking, any other body of citizens may incorporate for exactly the same purposes and carry on exactly the same kind of business. A company organized to operate a public utility must, however, have special rights and powers affecting the public welfare or convenience, and usually another similar corporation would not be granted these identical rights and powers while the former corporation was in active existence. For instance, a gas company must have the right to tear up streets in order to lay and repair its pipes. The ordinary citizen or corporation has no such right. If such right were granted to one company, the same right in the same territory would not properly be granted to another company. Should such double concession be made, it would be but a short time until, in obedience to well-known economic laws, the two competing companies would combine.

This peculiarity is true of all classes of public utility corporations. They enjoy franchises that cannot be granted indiscriminately, and that tend inevitably to monopoly. They enjoy these special privileges for the purpose of supplying certain public needs that must be supplied uniformly. They cannot be given the liberty to make prices and conditions that obtains in the conduct of a private corporation. Hence the laws under which they receive charters should guard against the indiscriminate bestowal of such rights and should carefully regulate charges and methods.

In many states the charters of public utility corporations are only granted by special acts of legislation, in others, commissions pass upon such applications and decide whether the public welfare requires the issuance of the desired charter, while in other states such corporations are chartered under the provisions of general laws.

§ 80. Financial Corporations.

Experience has shown that it is unsafe to allow irresponsible parties to incorporate and conduct banks, trust companies, savings institutions and similar associations dealing with the funds of others. Hence, institutions of this sort are now so hedged about with restrictions and limitations that, in a measure, their conduct is confined to reputable and responsible people. Their safety is also at least partially assured by stringent rules as to the payment of stock subscriptions in cash before business is commenced, and as to the liability of their stockholders thereafter. In national banks and in many state banks this stockholder's liability is equal to the face value of his stock, thus nominally placing $200 behind each $100 of stock as security for deposits and credits made to such institutions.

Usually charter applications for financial corporations must be approved by some department or official of the state; and after incorporation their affairs are subject to the inspection and supervision of the state officials, and their officers are required to make regular reports of their business and financial condition. National banks are under the jurisdiction of the United States laws and are not subject to this supervision and regulation from the authorities of the state in which they operate.

Speaking generally, both public utility corporations and financial institutions chartered by the state are subject to the usual statute law regulating stock corporations, and in addition to such special legislation as may affect them. If doing business in other states they would be governed by the local regulations affecting such foreign corporations.

§ 81. Charter Details.

When a corporation is to be organized, all the important features which are peculiar to the new corporation and which are not secured to it by the common law, or necessarily incident to incorporation, should appear in its charter. These are usually

the name, purposes, duration, location, capitalization and the details thereof; also in some states the number of directors and the names of those who are to act for the first year, and any desired special provisions that can be made a permanent part of the corporate organization under the laws of the state of incorporation. Temporary or less important details may be left for by-law or other regulation, but all matters of permanence or importance should appear in the charter as far as possible. The statutes usually require the main features outlined above to appear in the charter.

In New York, New Jersey and some other states, special provisions may be inserted in the charter for the regulation and conduct of the corporate business and affairs and for any proper limitations on the powers of its officials. This leaves wide scope for the insertion of such provisions and many peculiar arrangements result from this freedom.

§ 82. Application for Charter.

Special charters are secured—where not prohibited by constitutional provision—by application to the legislature of the state. The charter application is put in the form of an act declaring that certain named parties and their successors are a body corporate for the purposes enumerated. This act, if passed, becomes the charter of the company and is its sole authority for existence and operation.

The granting of special charters leads to grave abuses and in many states is prohibited by constitutional provisions. In other states, however, as in New York, such charters are still granted, and charters may be secured either under the general corporation laws, or, where sufficient influence exists, by direct appeal to the legislature.

In most, if not all the states, general laws have been passed prescribing the method whereby charters may be secured. These laws are modified by special additional requirements in the case of financial and public utility corporations. Under the provisions of such general laws when due and proper applica-

tion is made with payment of the proper fees, the Secretary of State must issue a charter in accordance with the terms of the application, or, if actual issuance of the charter is not required, the official acceptance and filing of the application, *ipso facto,* authorizes the parties to organize as a corporation.

This is the usual procedure under which the great majority of modern business corporations come into existence. It is a matter of right, not of favor, and is available equally for all qualified persons who choose to comply with the necessary formalities and pay the required fees. (See Forms 1 to 4.)

CHAPTER XIII.

INCORPORATORS.

§ 83. Who may Incorporate.

Corporations are creatures of the law. They derive their right to existence either from direct legislative enactment or from the general laws under which they are formed. This being true, only those may incorporate who are expressly authorized thereto by these special acts or under these general laws. In each state the statutes must be consulted in order to ascertain definitely just who may participate in any proposed corporation.

Usually the statutes authorizing incorporations employ the term " persons " or " natural persons " in prescribing who may incorporate. This wording excludes a firm, a corporation, or any one acting in a representative capacity, from participation in an incorporation. Any of these might hold stock in the corporation when organized, but could not legally act as an incorporator.

As the charter is in effect a contract, a person unable to contract cannot properly act as an incorporator. This is a matter of common law and excludes minors, persons of unsound mind and others incompetent to contract. Under the old common law, it would also exclude married women, but this disability has been generally removed and married women frequently act as incorporators.

In some states one or more of the incorporators must be citizens of the state of incorporation. Unless this were expressly prescribed, any person otherwise competent could act whether a citizen of the state or not. Incorporators need not even be citizens of the United States unless expressly required

by the statutes. In New York, at least one of the incorporators must be a resident of the state, and two-thirds of the total number must be citizens of the United States. In New Jersey none of the incorporators need be citizens either of the state or of the United States.

It must be borne in mind that each state has the entire right to impose any qualifications on incorporators that may seem desirable and that there is no appeal from such statutory requirements. Usually, however, the matter is not of great importance, as, if any of the proposed incorporators are barred by statute requirements, a substitute may be appointed who is qualified, and who will act up to such point as is necessary or desirable and then transfer his subscription and all his rights to the party for whom he has been acting. (See § 87.)

§ 84. Number of Incorporators.

The minimum number of incorporators is prescribed by statute, and in most states is three, though in a few states five are required. No maximum number is designated in any state, this feature being a matter of no importance from the standpoint of the state.

As a general rule it is advisable to incorporate with the minimum number of incorporators permitted by the statutes. Usually each incorporator must sign and acknowledge the charter application, and must either sanction or participate in the first meeting, and these proceedings are much facilitated by a small number of incorporators. At times different interests must be represented in an incorporation and the subsequent organization, and a considerable number of incorporators is therefore unavoidable, but without some such reason the minimum number is to be preferred.

§ 85. Functions of Incorporators.

The incorporators furnish the nucleus about which the proposed corporation is formed. Their function is merely to participate in certain formalities incident to the creation of the

corporation. They must usually sign and acknowledge the charter and are generally required to be subscribers to the stock of the corporation. They call and conduct the first meeting. The organization of the corporation is usually entirely in their hands, though in case they are not the real parties in interest the organization and first proceedings will be prescribed for them in advance.

It will be seen that the only necessary function of the incorporators is to figure in certain formalities essential to the formation of the new corporation. They may be the real parties in interest who will remain with and own stock in the new corporation, or they may be "dummy" incorporators, called in merely as a matter of convenience, or for more cogent reasons, without interest in the corporation beyond their perfunctory subscription for one or more qualifying shares—an interest that is usually assigned to the real parties in interest so soon as the corporation is once organized and ready to begin its operations. (See § 87.)

§ 86. Incorporators as Stockholders.

It is usual for incorporators to be subscribers for one or more shares of stock in the proposed corporation. In most of the states, such subscription is either required, or it is assumed that such subscription will be made. If not either directly or inferentially required by the statutes, such subscription is not essential.

When an incorporation is effected with incorporators who do not desire, or are not desired to remain as permanent stockholders, it is usual after the organization has been completed, for the incorporators to assign their subscription rights or their stock to those parties who are to be stockholders. These latter assume the obligations of the incorporators on the assigned subscriptions or stock, and, if the transaction is acquiesced in by the corporation, it is then legally complete and the original incorporators are discharged from any subscription obligations. (See § 87.)

§ 87. Dummy Incorporators.

As has been stated, any competent person may join in an incorporation without any material or permanent interest in the matter, and such non-interested or "dummy" incorporators are frequently employed. Sometimes this is done where the real parties in interest do not wish to appear as incorporators, sometimes of necessity because of the absence of the principals, and sometimes purely as a matter of convenience, the real parties concerned being disinclined or too busy to undertake themselves the technical duties of incorporators.

In such cases, the dummy incorporators execute the charter and organize the corporation, usually subscribing for the smallest number of shares that will satisfy the statute requirements. The organization will be carried to such point as the real parties in interest or their attorneys indicate, and the "dummies" then assign their subscription rights or stock, resign any official positions they may hold in the new corporation and step down and out.

Such an incorporation, if properly conducted, is entirely legal and is the method pursued in the formation of almost all the larger corporations and combinations. The proceedings are, as a matter of course, supervised and ordinarily conducted by the attorneys of the parties really interested, these attorneys dictating all that is done and seeing that the interests of their clients are properly conserved. The proceeding is carried as far as the conditions render advisable before the dummy incorporators make way for their principals. Usually they fully complete the organization of the corporation, electing themselves directors, sometimes electing the permanent officers and at other times filling these official positions temporarily themselves, meanwhile taking action of the greatest moment to the future of the new corporation.

The organization of the United States Steel Corporation was effected in this way. Three incorporators were provided, each of whom subscribed for ten shares of stock out of a total

capitalization of but $3,000. The incorporation was then effected, the organization of the new corporation was completed, the incorporators were retired, and the capitalization was increased to $1,100,000,000. (See Form 6.)

In such cases the incorporators are usually the junior counsel and clerks in the offices of the attorneys having the incorporation in charge. As stated, if the incorporators are properly qualified and the proceedings are conducted in accordance with the statute requirements, there is no question as to the legality of the method. (See § 210 and cases there cited.)

CHAPTER XIV.

THE CORPORATE NAME.

§ 88. How Secured.

The name of any proposed corporation must be set forth specifically in its charter application. This name, so soon as the application is allowed, becomes the name and property of the new corporation. For that state the right to such name is exclusive.

If the name chosen were the same as that of some other domestic corporation or foreign corporation licensed to do business within the state, or so nearly the same as to cause confusion, that fact alone would be ground for the rejection of the charter application. If, under such circumstances, the application were inadvertently allowed, the name would technically become the property of the new corporation, but the other corporation would have the superior right and could by injunction prevent any conflicting use.

But few statutory restrictions exist in regard to the corporate name. The prohibition against the adoption of a name similar to that of a corporation already doing business under the state laws is the most important. In some states the prefix "The" must be used to introduce the corporate appellation; elsewhere "corporation," "company," "association" or some other word expressing the idea of association must be used in the corporate name. In some few states, the word "incorporated" or "limited" must follow the corporate designation.

The state authorities have no right to refuse a charter application on the ground that some foreign corporation,

not licensed by the state, is using the selected name. In such event the charter application, if no other objection existed, must be allowed and the right to use the name left to be settled between the two corporations. (See § 90.)

§ 89. Selection of Name.

The selection of the corporate name is frequently a matter of considerable importance, though usually governed by business considerations rather than legal rules. As a matter of both taste and business a name should be selected that is distinctive, not too long, and, if possible, expressive of the business to be done by the corporation.

In the incorporation of a partnership, the general plan is to retain the partnership name with only such changes as will indicate the corporate organization. (See § 247.)

In most states great latitude is allowed in the selection of the corporate name, the prohibition against conflicting names being practically the only restriction. If not required by statute, the use of the prefix "The" is to be avoided as unnecessarily lengthening the name and producing a peculiarly awkward effect in legal instruments when the name is used, following the word "said" as is frequently the case.

Hackneyed names such as "Standard," "Excelsior," and "International," as well as much-used geographical names are to be avoided, both as a matter of taste and business. No trade-name rights can ordinarily be secured in such well-worn designations.

§ 90. Right to Corporate Name.

One important object of incorporation is to secure permanence, and the corporate name is an almost essential element of this desired commercial continuity. Once established, the name is the embodiment of the good-will of the enterprise and has a value in accordance. If the corpora-

tion is properly managed and is successful this value may be and frequently is very considerable. In some instances it has been the chief asset of a valuable business.

The corporation's right to its name is the same as to any other trade-mark or trade-name possessed by it, and is generally more easily established. If the name is used by other parties without authority such use may be stopped by injunction, and, if damage can be shown, an action will lie against the offending parties. (Higgins Co. *vs.* Higgins Soap Co., 144 N. Y., 462, 1895; Columbia Co. *vs.* O'Brien, 101 App. Div., N. Y., 296, 1905.)

As has been stated, there is usually no statute restriction against the adoption of the name of a foreign corporation by a domestic corporation if such foreign corporation has not been licensed to operate in the state. The allowance of such name would not, however, give the new corporation an unquestioned right to its use. If the older corporation could show that it had a trade right in the name, and that the use of the name by the new corporation would be injurious to these rights, the new corporation might be enjoined from the use of such name and if the injunction should be sustained would be compelled either to secure a new name by due and formal precedure or discontinue its operations.

§ 91. Changing the Corporate Name.

Occasionally it becomes necessary or expedient to change the corporate name. It may be that the use of the name first adopted is prevented by injunction, or new interests may have come in, that, as a matter of business policy, must be represented in the corporate name, or possibly the corporation has been unsuccessful, or has achieved a bad reputation, and the adoption of a new name is thought desirable. In any such case, the name may only be changed with the permission and sanction of the state.

In many states, the change of name is secured by an amendment to the charter, which is a more or less trouble-

some operation according to the statutory requirements of the particular state. Other more or less troublesome proceedings obtain in different states, as in New York where the prescribed method of changing the corporate name is by formal court proceedings. On account of these difficulties in some cases it is simpler and no more expensive to organize a new corporation and transfer to it the assets of the existing corporation, than to take the time and trouble incident to a change of name by the regular procedure.

CHAPTER XV.

THE CORPORATE PURPOSES.

§ 92. General.

An individual or firm may do anything or engage in any form of business not prohibited by the laws. A corporation, on the contrary, may only do those things and engage in those businesses permitted it by the law and set forth in its charter. This renders it important that the charter should clearly and fully empower the corporation to do all those permissible things that may be necessary in its operations.

Usually the general corporation laws in each state specify the purposes for which corporations may be organized. In some states these purposes are limited to certain classes of pursuits, and corporations cannot be formed for purposes not specifically included. Mining and manufacturing corporations are authorized in all states. In most states the laws specify mercantile and trading corporations as well. Some states go still further and broadly authorize the formation of corporations for " any lawful business," " any lawful industry or pursuit " or for " pecuniary profit."

Under these latter clauses it would be difficult to discover any legitimate calling or pursuit that can not be undertaken by a corporation. The tendency of the present day is towards liberality in this respect and the few limitations that do exist are gradually being removed.

§ 93. Single Purpose.

Formerly the rule was to organize corporations for a single purpose, as to mine for silver, to manufacture shoes, or to conduct a trading business in some specified line. In a few states this is still the rule and a corporation will not be chartered for

more than one purpose. The authorization for this one purpose would, as a matter of course, carry the right with it to do all things necessary or proper to effect that purpose, but nothing further. If another line of business were to be taken up a new corporation must be organized, as the powers of the old corporation could not be extended to cover the new pursuit. That is, if the silver mining company wished to mine for copper also, it could not secure specific authorization thereto and a new company would be required to accomplish this purpose.

At present this rule has been practically abrogated. It still prevails in a few states, but generally a corporation will now be empowered for as many legitimate purposes as may be included in the charter application. In some few cases, however, it is still advantageous to confine the corporate activities to one specific purpose. For instance, if a partnership is incorporated, it may be advisable to restrict it to the purposes of the business already under way. This would prevent any subsequent diversion of the corporate activity and resources into other and possibly dangerous channels. The corporation could conduct the one business and that alone. It would have no power to venture into new and untried fields.

§ 94. Comprehensive Purposes.

At the present time the tendency in corporate organization is towards comprehensive purposes—purposes that will permit the corporation to undertake and operate any line of business, in any part of the world and under any conditions. It is the natural desire to secure all powers and privileges that may be had—not that they are all needed or to be exercised, but unforeseen opportunities may occur when these powers will be required. Incorporators are pleased with these extensive arrays of possible activities, investors and interested parties generally expect them, and, as their inclusion is a matter of little difficulty, nearly all modern charters enumerate almost every conceivable branch of business and every kind of enterprise allowable under the statutes. (See Forms 6 and 7.)

In some cases this has been carried to an absurd extreme, but in general the practice has its advantages. There is no good reason why corporations should not have the same free range of business activities possessed by the individual or firm, and the effort of the present day is to approximate as nearly as may be to this ideal.

It is to be noted, however, that this end could be attained with equal efficiency and with much less trouble and verbosity by a few general statements of comprehensive scope. The entire purposes of the most elaborately extended charter could be obtained in their full force and efficiency by a few well turned phrases.

§ 95. Illegal Purposes.

No state of the Union allows the organization of a corporation for illegal or immoral purposes. Where state officers inadvertently, or by intent, allow charters for such purposes, the authorization of these charters is void and ineffective and will not protect the stockholders from any penalties and liabilities that would be visited upon the members of a partnership engaged in similar undertakings.

This would apply to any business, occupation or organization in direct violation of the laws of the state of incorporation, such as lotteries, gambling and combinations in restraint of trade.

Apart from these manifestly illegal or immoral undertakings, any purposes not allowed to corporations under the laws of the state are illegal. A charter for any such purpose, even if allowed by the state officials, would be ineffective and the stockholders would be held as partners in case of the insolvency of the enterprise. This does not often happen at the present day, as most of the states allow incorporation for all proper purposes and the possibility exists only in those states where corporate purposes are still restricted.

Also it is to be noted that if a portion of the purposes is legitimate and proper, and a portion unauthorized, the charter

would be held good as to the legitimate portions and as non-existent and non-effective only in those portions unauthorized or in conflict with the laws.

§ 96. Things "Ultra Vires."

Things otherwise legal but not specified among the charter powers of the corporation are beyond its powers, or *ultra vires*. Contracts made in pursuance of such unauthorized ends cannot be enforced against others, although the corporation itself is usually bound. Directors and officers may make themselves personally liable for involving the corporation in such transactions.

Both creditors and stockholders have the right to object to any action of the corporation exceeding its legal powers. It is to be noted, however, that if the stockholders assent and there are no creditors, there is no one to object if a corporation does exceed its charter powers. Under these circumstances such powers may be exceeded without danger to the officers and directors. Owing to the broad powers that are now usually granted, the doctrine of *ultra vires* has much less importance than formerly. A modern text book says:

> "The old theory of a corporation was that it could not legally do anything in excess of its express or implied powers. But the modern view is that a private corporation may, if all its stockholders assent and if creditors are paid. Public policy does not require business corporations to confine themselves strictly within the limits of the words of their charters." 1 Cook on Corporations, § 3.

(See series of modern cases in 64 L. R. A., 366, *et seq.*, on implied powers of corporations.)

CHAPTER XVI.

STOCK CLAUSES.

§ 97. General.

In most states the capital stock of a corporation and the divisions and general features of this capital stock must be stated in, and are fixed by the charter. In a few states, stock with special preference or features may be issued after the allowance of the charter by certain specified action of the stockholders, but as a general rule everything relating to the stock is fixed once for all by the charter and may only be changed thereafter by an amendment of that instrument.

Usually the charter must state the full amount of the capital stock, its division into common and preferred stock, if such division exists, the number of shares into which it is divided and the par value of each share. This par value is usually the same for all the shares, though not necessarily so. The par value of the common stock might be fixed at $10 per share, while the par value of the preferred stock was fixed at $100. Generally such variations of the par value are not advisable.

§ 98. Classifications.

Any classifications of the stock should be very clearly set out in the charter. These classifications are varied and numerous. The most usual is that of common and preferred stock. This preferred stock may be divided into different classes as to precedence in dividends, or as to amount of dividend, or as to participation in assets, or as to redemption features, or as to participation in dividends beyond preferred dividends, or as to voting or other powers.

The common stock is sometimes classified in regard to voting powers, each portion or class having the right to elect a

certain number of directors, or at times one portion of the common stock may be given the sole right to vote upon certain kinds of questions, or under certain contingencies.

Such charter classifications are not allowable in all of the states, but the same result may be attained in many cases by suitable by-law enactments, unanimously adopted at the first meeting of stockholders. As stated by Judge Folger in Kent *vs.* Quicksilver Mining Co., 78 N. Y., 178 (1879):

> "We know nothing in the constitution or the law that inhibits a corporation from beginning its corporate action by classifying the shares in its capital stock with peculiar privileges to one share over another and then offering its stock to the public for subscription thereto." (See §§ 49, 114, 232, 239 and 252.)

§ 99. Common Stock.

Usually the charter provisions affecting common stock are few and simple. If the corporation were to be capitalized at $100,000 with shares of the par value of $100, without preferred stock or classifications of the common stock, the charter would merely state that the capital stock was to be $100,000, divided into 1,000 shares of the par value of $100 each. Nothing more would be necessary. The fact that it was all common stock, that this was unclassified and that there was no preferred stock or restrictions of any kind on the common stock, would be understood without specific statement.

If there are to be any classifications of the common stock, or any restrictions upon it in any way, these must be stated in the charter, specifically and in detail. The mere fact that common stock is usually unrestricted renders it the more necessary to be clear and explicit if restrictions are to be created.

§ 100. Preferred Stock.

Preferred stock, by its mere existence, indicates the fact that it has features not possessed by other stock of the corporation, but the differences and preferences which distinguish

it should be stated as clearly as possible in the creating clause and also so concisely, if it may be done, that the entire clause may be printed on the face of each certificate of this preferred stock.

It should be borne in mind that unless otherwise provided by the charter, preferred stock has all the rights of common stock in addition to its preference; that is, it would vote, participate in any dividends in excess of its preferential dividend, participate in any distribution of assets on the dissolution of the corporation, and, generally, be on exactly the same plane as common stock, except as to the indicated preference in dividends. If any of these rights are to be denied it, such denial must be clearly expressed. If it is to have any rights other than its preference dividends, these rights must also be clearly indicated. Nothing should be left to implication, or be taken for granted. (See Chap. VIII, Preferred Stock.)

CHAPTER XVII.

LOCATION AND DURATION OF CORPORATION.

§ 101. Domestic and Foreign Corporations.

In its own state—the state in which it is incorporated—a corporation is a "domestic corporation." Elsewhere it is designated a "foreign corporation." In its own state it usually enjoys rights and privileges not accorded a foreign corporation, hence, unless there is some strong reason to the contrary, it should always be incorporated in the state in which the larger part of its business is to be done.

§ 102. Selection of State.

The usual inducements for foreign incorporation are the smaller fees and taxes of the selected state. (See Chap. V, Cost of Incorporation.)

Unless there is a material difference in favor of foreign incorporation, it should be avoided. Corporations organized outside the state are always liable to adverse discrimination, and, in many states, are at a positive disadvantage in event of litigation. (See Chap. IV, Where to Incorporate.)

§ 103. Principal Office.

Usually the location of the office in which the corporation will have its headquarters must be designated in the charter application. In New Jersey and most of the other states, this principal office must be located definitely. In New York, the borough and county in which the principal office may be found must be given, but neither then nor later is any more definite address required. This renders it impossible to secure the

local address of a corporation from its charter—a seemingly serious omission.

It is a general principle of law that stockholders' meetings must be held within the state of incorporation and the principal office in that state is usually designated by the by-laws as the place where such meetings are to be held. One or two states, by statute provision, permit stockholders' meetings to be held outside the state but the practice, though convenient in some cases, is, generally speaking, objectionable.

Meetings of the directors must also be held within the state of incorporation unless permitted elsewhere by statutory provision. Such permission is given by several of the states, and, used under proper regulations as to the place of meeting and notice thereof, is at times of much advantage.

Meetings of both stockholders and directors are usually held in the principal office in the state of incorporation. To allow meetings of either stockholders or directors to be called elsewhere, unless in places formally designated by the by-laws or agreed to by all parties in interest, gives opportunity for grave abuses. The by-laws should designate the principal office and, unless there is good reason for doing otherwise, prescribe that all corporate meetings be held therein.

The principal office in the state of incorporation is usually designated by the statutes as the place where legal process may be served on the corporation.

§ 104. Duration.

In certain states, the existence of a corporation is limited to some fixed period as twenty or fifty years. In most of the states, however, its duration may be made nominally perpetual. This unrestricted duration is advantageous and is in line with the greater liberality manifested towards corporations in later years. No serious objection can be urged against it, the re-incorporations necessary in the short

period states are avoided, and the general stability of the corporation is improved.

Where the period of corporate existence is limited, the extreme time allowed by the statutes is usually selected with the expectation of a re-incorporation at the end of the stated period. At times, limited periods are preferred for the corporate existence in order to definitely limit the period of the associated undertaking. In such case, at the end of the selected term, the corporation expires by limitation, its assets are distributed, and the corporate venture is terminated. Usually such distribution is made under some prearranged plan in order to avoid the losses and injury to good-will of a forced liquidation.

CHAPTER XVIII.

THE BOARD OF DIRECTORS.

§ 105. Qualifications.

At common law it was not required that directors should be stockholders. In most states of the Union this has been modified by statute provisions requiring that directors hold one or more shares of stock. Such provisions do not apply, unless expressly so stated, to directors named in or appointed by the charter. In New York, the statute requiring directors to be stockholders may be waived by proper charter or by-law provision, and persons not stockholders may then be selected as directors of the corporation.

In general it is very advisable that directors should be stockholders of the corporation in which they act, and the liberality of the laws in permitting persons who are not stockholders, or who hold but one or two shares, to act as directors, is not in the best interests of stockholders. Occasionally the privilege may be advantageous, but as a general rule the management of a business enterprise cannot safely be placed in the hands of those having no material interest in its success, and the incorporation of an enterprise does not except it from this rule.

In most states, one or more of the directors must be residents of the state of incorporation. In such cases, where the parties really interested reside in other states than the one selected for incorporation, resident directors must be secured. In some states, as New Jersey, Delaware, Maine and South Dakota, this has led to the organization of concerns whose sole business is the supplying of resident directors and the representation of outside corporations

organized within the state. At times this results in giving some dummy director the deciding vote as between two equally divided factions of the board.

Unless debarred by some statutory prohibition, anyone capable of acting as an agent of a corporation might act as its director. A trustee, or an executor of an estate consisting in part of stock, would be eligible as a director. Under the modern statutes removing the disabilities of married women, they may act as directors. Unless expressly prohibited by statute, aliens may also act as directors. (See § 151.)

§ 106. Number.

Within certain limits the number of directors is usually designated by the statutes. The exact number within these limits is, in most states, fixed by the charter. In practically all the states a minimum number of directors is fixed by the statutes, though in many no maximum number is prescribed.

In general the board should be fixed at the lowest number that will permit due representation of the various interests involved and provide for the proper transaction of business. In small or close corporations it is usual to select the minimum number of directors permitted by the statutes. In the larger corporations more directors are usually necessary in order that all the interested parties may be represented, or in order that all the parties really concerned in the management of the corporation may participate in the deliberations and actions of the board. Frequently the board is increased far beyond the needs of management in order to secure names that will attract investors and add to the apparent financial stability of the corporation or benefit it in other ways.

If the number of directors is made too large it is difficult to secure a quorum, meetings are apt to become infrequent and perfunctory, the members of the board do not keep in touch with its business, and some further device must be resorted to

for the real conduct of the business. Under such circumstances the management may be left in an irregular way to the officers and a few actively interested directors; usually, however, the difficulty is met by the appointment of an executive committee, to which is sometimes added a finance committee and upon occasion other special committees. These committees then exercise the powers of management that usually pertain to the board. (See § 110 and Chap. XXVI, Standing Committees.)

For the business operations of an ordinary corporation a board of five or seven members—three or four, respectively, forming a quorum—is far better than a larger board in nominal control, but with special committees doing the real work.

§ 107. Authority.

The stockholders are the owners of the corporate property, but the direct, active and immediate control rests with the board of directors. The authority of the board exists under the common law, extends to all subjects connected with the management of the corporate affairs, and, unless in some way restricted, is practically supreme. Its actions in the conduct of the corporate business cannot be questioned or interfered with by the stockholders unless in case of gross mismanagement or actual fraud. As far as the corporate management is concerned, the stockholder's position is but little more than that of an interested spectator.

If such unrestrained power in the hands of the board is considered undesirable, it may usually be restricted by charter provision or by-law regulations. In a few states certain restrictions—and in some cases extensions—of the power of directors are found in the statutes.

Where special charter provisions are permissible, restrictions upon the power of the board should be incorporated in the charter. If this is not possible they may usually be embodied in the by-laws, where they are equally effective but of much less stability, as by-law provisions are easily changed.

By either of these methods the power of the board to incur

obligations may be limited; their power to sell the assets of the corporation may be restricted; it may be required that two-thirds or other proportion of the entire number must concur in all expenditures above a certain amount; the payment of excessive salaries may be prohibited; expenditures within a certain period may be limited, and many other restrictions, depending upon the particular conditions, may be imposed. (See §§ 116, 117, 181, 236 and 243.)

§ 108. Power to Pass By-Laws.

The board of directors have no power to pass by-laws, or to amend existing by-laws, unless expressly authorized thereto by the statute law, the charter of the corporation, or its by-laws. Where special provision cannot be included in the charter, the only method of giving the directors power to amend the by-laws is by express by-law provision. The stockholders may legally delegate their power in this manner.

It may be advisable that the board shall have power to pass additional by-laws to meet new situations and emergencies as they arise, and this power may be given them by an authorization to supplement the by-laws adopted by the stockholders. This is as far as is prudent. To place unrestricted power to make and amend the by-laws in the hands of the board would seem a dangerous and unnecessary removal of one of the most important safeguards of the corporate form.

In the smaller corporations where a stockholders' meeting may be readily called in case of an emergency, there would seem to be no real object or advantage in giving the board any power whatsoever over the by-laws. In the larger corporations the power should only be granted with caution as one that is of but occasional utility, and that may be used to the disadvantage of the general corporate interests. (See § 128.)

§ 109. Classification.

The classification of directors in such manner that but a portion of the board is elected at any one annual meeting, is at

times a convenient and advantageous arrangement. Its object is to prevent the violent alteration of policy which might occur should the entire board be changed at one time, and also to render the selection of desirable members more probable by lessening the number to be elected at any particular election.

It is to be noted that the classification of directors is but seldom necessary where cumulative voting prevails, as the sudden change of the entire board that may result from a passing of the control is then hardly possible. Also in the smaller corporations such classification is but rarely necessary and is seldom adopted.

The most common classification of directors is the division of the board into three classes equal in number, each class holding for three years, and one class being elected each year. Under this plan three years is required for a complete change of the personnel of the board.

Classification of directors is attainable in almost every state. Where permissible, such classification should be provided for in the charter. Where special provisions are not allowed in the charter, it may usually be secured by by-law provision. Unless actually prohibited by the statutes or precluded by implication, it would be lawful to provide for such classification by either charter or by-law provision.

It is unusual to provide for more than three classes of directors, and such classified board should preferably consist of some such number, as three, nine or fifteen, permitting three equal divisions. The classes might be made unequal, that is, if the board consisted of eleven members, three might be elected one year, four the next year and four the third. Such arrangement is, however, not common.

Upon the organization of a corporation with a classified board the whole number of directors would usually be elected at once, the term or class of each director being decided by some agreed method. For instance, in a board of nine members, divided into three equal classes, the three directors receiving the greatest number of votes might constitute the

longest term class, the three receiving the next highest number of votes constitute the class for the intermediate term, and so on. (See § 153.)

It is to be noted that the stability of management sought by classification of directors may be secured, and, at times, even more efficiently and conveniently by the creation of a voting trust. This subject is considered in Chapter XXXV, "Voting Trusts."

§ 110. Standing Committees.

The board of directors is the managing body of a corporation and supposed to be in direct charge of its affairs. When the board is of moderate size this direct supervision is usually exercised, but when the directors are numerous it is not always practicable, and standing committees are then usually employed.

These committees are appointed or elected in such manner as may be prescribed by charter or by-laws, must be composed of members of the board of directors, and, subject to the provisions by which they are created and empowered, usually exercise all the powers of the board in their respective fields.

Any necessary number of these committees may be appointed, but they are usually limited to two, the executive committee and the finance committee, the first-named committee exercising its powers over the general affairs of the corporation, while the powers of the last-named committee are usually confined to matters relating to finance. (See Chap. XXVI, Standing Committees.)

CHAPTER XIX.

SPECIAL PROVISIONS.

§ 111. General.

The first general laws relating to incorporation were harsh. Plurality of purpose was not allowed, the privileges granted were few and all corporations were to be organized and operated on exactly the same lines. But one mold was provided, and if this did not happen to fit the needs of any particular corporation, relief could only be had by recourse to a special charter or enabling act.

These narrow and unnecessary limitations were slowly and grudgingly relaxed, but no marked advance was made in corporate legislation until New Jersey recognized the necessity of greater freedom and flexibility in this direction and the very material advantages that might accrue to the state itself from more liberal corporate legislation. Her legislators then proceeded to remodel the bare laws then existing, so as to allow a plurality of purposes, all proper special powers and a freedom and convenience not theretofore enjoyed by corporations formed under general laws. To this politic concession to the reasonable business demands of the times is principally due the repute—and resulting revenue—New Jersey now enjoys as a state for incorporation.

The principal statute by which this greater scope and freedom of action was granted to New Jersey corporations is as follows:

> "The certificate of incorporation may also contain any provision which the incorporators may choose to insert for the regulation of the business, and for the conduct of the corporation, and any provisions creating, defining, limiting and regulating the powers of the cor-

poration, the directors and the stockholders, or any class or classes of stockholders; provided that such provision be not inconsistent with this act." Paragraph VII, section 8, General Corporation Law of New Jersey.

This statute enables the incorporators to secure through charters granted under the general laws, powers, privileges and regulations formerly only possible under special charters. This statute has been followed in Delaware, to a certain extent in New York, and, with more or less variations, in a number of other states.

In those states in which special charter provisions are not allowed, many of the desired powers, restrictions or regulations may be obtained through by-law provisions. In some instances this may be done effectively by proper arrangement, but usually the by-laws may be amended or repealed with comparative ease, and their provisions do not always have the necessary permanence. (See Part IV, "By-Laws.")

Where the statutes do not permit special charter provisions, and desired provisions cannot be properly or permanently included in the by-laws, the only recourse is incorporation in some more liberal state where such provisions are allowable. The corporation would thereafter operate in its own state as a foreign corporation. Outside incorporation for such a purpose would only be justified where the special provisions obtained thereby were of considerable importance. (See Chap. IV, Where to Incorporate.)

§ 112. Usual Objects.

Under the head of special provisions come many of the features already discussed, such as cumulative voting, classification of stock, classification of directors and limitations of the directors' power of incurring obligations. In addition many other provisions of only individual corporate application might be included, as limitations on the voting power, limitations on salaries and provisions authorizing a reserve fund or the accumulation of operating capital.

The variation of the statute laws as affecting special provisions is wide, as, for instance, in New Jersey by charter provision the directors may be empowered to alter, amend or repeal by-laws, while in New York the exact power of the board as to by-laws is laid down in the statute law and cannot be denied or modified in any way by charter provisions. Also in New Jersey the directors may be empowered by the charter to mortgage any or all of the corporate property without consulting the stockholders; but in New York the corporate property may only be mortgaged with the consent of two-thirds of the stockholders of the corporation, and any charter provision to the contrary would be absolutely non-effective. On account of this wide difference the statutes of the state of incorporation must be consulted when special provisions are under consideration.

§ 113. Cumulative Voting.

Cumulative voting is frequently employed as a protection to minority interests. By its action any material minority is assured representation on the board of directors. As its name indicates, the system depends upon a cumulation or concentration of votes. Under its provisions, the owner of a share of stock may at any election of directors, cast one vote for each director to be elected, or may cast the same number of votes for one director, or may distribute such votes among two or more as he sees fit. That is, if the total number of directors to be elected were seven, the owner of one share of stock might cast one vote for each of the seven directors, or might cast seven votes for one director, or cast four votes for one director and three for another, or apportion his seven votes in any other way among the candidates.

Under this arrangement even a small minority, if properly combined, may secure representation on the board. At times this representation becomes of much importance. If the minority are not represented they may be debarred from information and knowledge of what the majority propose to do, and

action may be taken which cannot be undone, but which the minority might have prevented by injunction or other means had they been informed. Also the mere presence of a capable minority representative on the board prevents many abuses of power that might otherwise occur. For this and other reasons, cumulative voting is, from the minority standpoint, always a wise provision, and occasionally becomes a matter of the most vital importance.

Cumulative voting may, in many states, be secured by inclusion in the charter. In Pennsylvania, South Dakota, West Virginia and some other states it is mandatory without reference to any charter provisions. In a few states, it is doubtful whether the provision would be allowed in the charter, or would be effective if included. Generally speaking, the method is fair and of great advantage to the minority interests. (See § 231 for full discussion of this subject.)

§ 114. Classification of Stock.

Where allowable by statute, stock may be classified in many ways. The most usual of these are the division of the capitalization into common and preferred stock, division of the preferred stock into classes, as first, second, etc., division of the common stock into classes, each class electing a due proportion of the directors, etc. (See Chap. VII, The Stock System.)

The division into common and preferred stock and the indicated division of preferred stock may be secured by charter provision in nearly every state in the Union, together with such other proper classifications of the preferred stock as may be desired.

The division of the common stock into voting classes, and the many other classifications occasionally employed, may usually be secured by special charter provision where such provisions are allowed. (See §§ 49, 98, 232 and 252.)

Where permitted by the statutes, the classification of stock may be, and occasionally is, carried into wide variations. Sometimes a portion of the stock will be denied the voting right entirely, or will be prohibited from voting on certain

questions. Certain stock may be debarred from participation in dividends for a stated period. In New York, a peculiar partly paid stock may constitute a part of the issue, drawing dividends only upon the amount actually paid.

These unusual arrangements are only desirable under exceptional circumstances. Generally they are to be avoided as being complicated, unnecessary and at times of uncertain result.

§ 115. Corporate Stockholding.

At common law a corporation cannot hold stock in another corporation. Though the law was not formulated with any such intent its practical effect was to render the formation of trusts and combinations extremely difficult, and, in many cases, impossible.

New Jersey was the first state to modify the law in this direction, and, under her present statutes, any corporation may hold the stock or the securities of another. New York followed New Jersey to the extent of allowing this right where provision was made therefor in the charter. Many other states have by recent enactment granted much latitude in this same direction.

The right is, at times, a very valuable one and in those states where allowed a provision authorizing the holding of corporate securities by the corporation is usually included in the charter. (See Chap. XXXIX, Holding Corporations.)

§ 116. Limitations on Indebtedness.

In a large proportion of the cases where corporations are wrecked, the result is brought about by the directors' abuse of the power to incur debt. In those states where the power of the directors in this respect may be limited by charter provision, such restriction is, on occasion, very desirable.

Under some circumstances it may be advantageous to fix an absolute limit beyond which the directors have no power to obligate the corporation. Or it may be provided

that if the directors exceed a certain sum, they shall be held personally liable for such excess. Or it may be provided that they shall not enter into any single contract involving obligations over a certain amount. Or it may be provided that obligations beyond a certain amount shall only be incurred with the affirmative vote of two-thirds, or other proportion of the whole board, or shall only be undertaken after authorization thereto by due resolution of the stockholders.

Whatever the plan adopted it should be carefully considered and adapted to the special situation, and the limitations should not be so low as to amount, or so narrow in application, as to interfere with the ordinary operations of the business. The abuse, not the use, of the debt incurring power is to be prevented. (See §§ 107, 181, 236 and 243.)

§ 117. Limitations on Salaries.

The diversion of profits by excessive salaries is a not uncommon method of draining the corporate treasury and preventing the payment of proper dividends. If not properly guarded against at the time of the organization of the corporation, such practice may be extremely difficult to correct or prevent later.

Limitations on salaries should not be made too narrow or too inflexible. Good management is an absolutely indispensible element of success and any limitations should not prevent fair salaries, with a possibility of more liberal payment when demanded by the welfare of the company, or justified by the excellence of the management.

This flexibility of restriction may be provided for in various ways. The charter provision may merely require that salaries be fixed, and varied thereafter if need be, by a two-third vote of the entire board. Occasionally the concurrence of the entire board may be required. Or the salaries of officers may be determined each year at the stockholders' annual meeting by a stated majority of the entire

outstanding stock. In such case the required majority may be fixed so high as to require the agreement of the minority interests. Or it may be provided that no official salary shall be increased over a stated figure, until a dividend of say 6 per cent. has been paid upon the outstanding stock for two or more years. Or any salary payments over a certain minimum might be made absolutely dependent each year upon the payment of a certain dividend for the previous year.

It is to be noted that where the ease of alteration is not objectionable, provisions limiting indebtedness and salaries are usually included in the by-laws instead of the charter. Here they may be modified as the circumstances demand. whereas in the charter they may only be altered by formal amendment of that instrument. But to protect the minority effectually such limitations must be inserted in the charter. (See §§107, 181, 236 and 243.)

§ 118. Sundry Provisions.

Many other provisions will on occasion be incorporated in the charter. Especially in the incorporation of a partnership or the re-organization or consolidation of corporations, special provisions are often necessary in protection of the varying interests as a pre-requisite to the proposed arrangement. (See Chap. XXXVIII, Incorporating a Partnership.)

It is essential that these provisions shall not go counter to any law regulating corporations and important that they be not such as to involve the corporation in any subsequent deadlock or entanglement. The death of parties, sale of stock to strangers, change of industrial conditions and other mutations may make apparently desirable arrangements exactly the reverse. It is not always possible to amend a charter and if there is any doubt as to the expediency, or effect of any particular provision, it should be brought into the by-laws rather than the charter. Then if found desirable, it may usually be amended or altered by a mere majority vote of the stockholders.

CHAPTER XX.

EXECUTION AND FILING OF CHARTER.

§ 119. General.

In each state the essential features of the charter are prescribed by its corporation laws. In many states a form of charter application is prepared by the state authorities and will be furnished by them on application. Where this is not done the forms are usually prepared by law stationers and kept on sale. Care should be exercised in the use of these prepared forms or undesirable features may be inadvertently adopted. Most of the published forms for some states—notably those for New Jersey and Delaware—include the objectionable provisions of the trust charters whereby the minimum of power is left with the stockholders and the rights of the minority are reduced to their lowest terms. Such features while possibly adapted to trust management, are not usually desirable for an ordinary corporation. (See Form 2, Delaware Charter.)

If any of these prepared forms have received the sanction or approval of the state authorities, such forms should either be used or be closely followed. To depart materially therefrom is to invite objection, which may at times be captious and in any case will cause delay and trouble. The authorities cannot be deemed unreasonable in their preference for these forms which have been passed upon, with which they are familiar, and which, when used, enable them the more readily to determine the legality and correctness of an application.

In addition to the usual provisions of the charter, any special provisions decided upon will be included and the charter application is then ready for the final formalities. These consist of its signing, acknowledgment and filing.

These final formalities are in a general way similar all over the country, but as the matter is one of statutory regulation the laws of the state of incorporation must be consulted for the details.

§ 120. Signing and Acknowledgment.

Each of the incorporators must sign and acknowledge the charter application. If there are but three incorporators and they come together for the signing and acknowledgment of the instrument, the formality is a simple one. The three acknowledgments are taken at the one time and one notarial certificate serves for all. If the notarial officer who acts in the matter calls on the incorporators at their offices or residences and takes their several acknowledgments, the one notarial certificate will still serve. If, however, the incorporators are numerous, live in other states, or for any other reason cannot be easily reached or assembled, the matter is more troublesome. Separate notarial certificates may then be necessary for each acknowledgment.

These acknowledgments may usually be taken by a notary public, commissioner of deeds, justice of the peace, or other officer authorized to take acknowledgments to deeds. If taken in another state, a certificate may be necessary as to the due appointment and authority of the officer by whom the acknowledgment is taken. The whole matter is one of statutory regulation which must be closely followed. The statutes are in most cases explicit as to the details of acknowledgment.

In addition to the usual execution by the incorporators, in some states it is necessary to secure the approval of the proposed incorporation by some designated court, or by a judge of such court, as one of the preliminaries to filing.

§ 121. Filing.

The technical details of filing the charter application vary to some extent in the different states. In some the application is sent directly to the Secretary of State, accompanied by the

prescribed fees. In others, the application must be sent direct to the Secretary of State, but the filing fees are paid the State Treasurer, who must certify to the Secretary that this has been done before the charter will be filed. Again in some states the charter must be filed with the Clerk of the County Court in the home county of the corporation, before filing with the Secretary of State; elsewhere the charter must be filed with the Clerk of the County Court after its filing with the State Secretary.

The treatment accorded the charter applications by the filing officials also varies in the different states. In some, these officials consider that the insertion of unauthorized or improper powers gives no legal authority, and that they are not called upon to decide the legal effect of the verbiage employed, and, in accordance with these views, accept any powers or purposes not openly in conflict, or glaringly outside the intent of the law.

In others, the authorities scrutinize the application in detail, and if its purposes and powers seem to exceed the statutory limits, the Secretary of State will decline to file the application. In such case the application is returned with an explanation or statement of the reasons for its refusal. At times the state authorities clearly exceed their authority in passing upon the legality of the indicated powers of a charter application. In such case if the matter were of sufficient importance and the delay not too serious, the courts might be invoked and the points in question be decided by competent authority. Generally, however, the importance of the matter will not justify such proceedings, and, if the official ruling cannot be changed, the purposes or other matters in question must be either omitted or so changed as to meet the views of the authorities.

If any required alteration in an executed charter is on some non-essential point, and all the incorporators agree thereto, it is not usually necessary to redraft and re-execute the entire instrument. The correction may be made in the original instrument and the document be then returned for acceptance in its corrected form.

If, however, the alteration be material, the better practice is to have the instrument redrawn and executed afresh by the incorporators. If, however, a material alteration were made in the instrument without any re-execution, but with the consent or subsequent acceptance of the incorporators, and the charter so altered were duly allowed and filed by the state officials, it is not probable that it could later be successfully attacked.

In some states, pursuant to the approved application, a charter is issued under the seal of state granting to the corporation the desired rights, powers and privileges. In other states the charter application itself changes its nature, and, as soon as filed, becomes the charter of the then authorized corporation. Its form is not changed, but its force is, and it is then an authorization from the state for the organization of the corporation with all the powers, privileges and characteristic features detailed in the one-time application.

§ 122. Certified Copies.

In some states the Secretary of State issues a duly certified charter under the great seal of state as part of the regular routine. In others, the Secretary merely notifies the party filing the application that it has been accepted and filed, this accepted application then becoming the charter of the corporation. In this latter case the Secretary will at any time upon payment of the legal fees furnish certified copies of the accepted application, or charter, which are due legal evidence of incorporation.

Where certified copies of the charter are to be recorded with the local authorities, they must, of course, be secured from the state authorities as part of the organization routine. Beyond this, the possession of a certified copy of the charter is of no importance, save very rarely in cases of litigation, and, on occasion, for its effect on interested parties, or parties to be interested in the corporation. It is usual, however, to secure and preserve a certified copy among the archives of the corporation.

CHAPTER XXI.

AMENDMENT OF CHARTER.

§ 123. General.

Charter amendments are usually the result of a too hasty preparation of the original instrument. Sometimes they are necessitated by changed conditions. At all times they are troublesome and to some extent expensive. They may be made either before or after the completion of the corporate organization.

New Jersey, with its usual accommodating recognition of possible corporate needs, permits the amendment of a charter by a very simple process before the corporate organization is completed. In this way new conditions may be provided for and the cruder defects of a new charter may be easily remedied. Thereafter, as in other states, the charter may be amended only by the regular procedure for such cases provided.

§ 124. Subject Matter.

Any provisions may be brought into a charter amendment that might have been brought into the original charter. As soon as allowed the provisions of such amendment become to all legal intents part of the original charter and as permanently binding on the corporation.

When an amendment has been made, such amendment and the original charter together constitute the working charter of the corporation, the amendment taking precedence over and modifying the original charter in all points of difference.

§ 125. Procedure.

The procedure for the amendment of a charter is, in each state, prescribed by law. There is but little uniformity in the

different states. In New York, for instance, the statutory procedure varies with the nature of the amendment. To change the name of the corporation, application must be made to designated courts. To change the number of directors, application must be made to the state officials.

Generally, an amendment of the charter requires a duly called meeting of the stockholders, at which a two-thirds majority of the stock interests outstanding must vote in favor of the proposed changes. The amendment, duly evidenced, as to the stockholders' authorization, must usually be filed in the same offices and with the same formalities as the original charter.

In some states advertisement must be made for a prescribed time before any such amendment goes into effect. The proportion of the stock vote, the notices to be given, and the other formalities also vary in the different states. In Delaware a bare majority have power to amend the charter.

PART IV.—THE BY-LAWS.

CHAPTER XXII.

GENERAL CONSIDERATIONS.

§ 126. Function of By-Laws.

A modern corporation is regulated, first, by the general laws under which it operates; second, by the provisions of its charter, and, third, by its by-laws. When the incorporators meet pursuant to the authorization of their charter for organization, both the general laws and the charter exist for the guidance of the new corporation. To these must be added the by-laws to provide for those details of organization, administration and business routine not covered by the laws nor provided for in the charter. This is the first and most important function of the by-laws.

In addition to this function, the by-laws are also usually so drawn as to constitute a systematic statement of the more important working details of both the general law and the charter. This is not done with any idea of adding to the binding force of the requirements of these higher authorities, but merely as a restatement, the by-laws being thereby rendered a more complete code for the guidance of the corporate officials and stockholders.

This use of the by-laws is customary and of considerable importance, insuring the observance of those statutory and charter provisions which if not in such accessible form, might be overlooked or forgotten.

§ 127. Subject Matter.

There is usually no law, save the law of necessity, compelling a new corporation to adopt by-laws. Its operation without by-laws would, however, be practically impossible—so much so that the law confers the power to make by-laws and takes it for granted that this right will be exercised. Provisions for the regulation of the corporation are found both in the statute law and the charter, but these are for the most part general in their nature. There are none of the specific details essential for the proper corporate operation.

Just what matters should be provided for in the charter, and what in the by-laws, is, to some extent, determined by the conditions of the particular corporation. The statutes usually prescribe certain essential matters that must appear in the charter. In addition, all such important matters, outside the ordinary routine of corporate procedure, as are intended to be permanent features of the organization should be incorporated in the charter. (See Chap. XIX, Special Provisions.) The routine details of corporate procedure, and any special provisions which are not intended to be permanent, or which are not permissible in the charter, are reserved for the by-laws. Generally speaking, nothing should be incorporated in the charter—outside of statute requirements—that may be as effectually provided for in the by-laws.

The by-laws, as has been stated, also usually contain many provisions of the statute law and the charter, which are repeated in the proper connection in the by-laws merely that these latter may, in themselves, be a complete working code. The by-laws will, then, contain all the ordinary working details of corporate regulation and most—if not all—of the important statutory and charter provisions directly affecting the corporation, frequent reference to the charter and to the statutes being thereby rendered unnecessary.

Under the head of routine details, the by-laws should, in strict conformity with any requirements of statutes or charter, provide for the issuance and transfer of stock,

the meetings of stockholders and directors, the election of directors and officers and the duties and limitations imposed upon them, the care and management of the property and finances of the corporation, and the other incidents of corporate procedure connected with these.

§ 128. Power to Make.

The power to make by-laws is one of the old common law powers enjoyed by corporations. Under the common law it resides in the stockholders duly assembled in lawful meeting. It may be delegated by them to the directors, but may be resumed at any time, and may only be exercised by the directors under such limitations as the stockholders prescribe. This power to make by-laws is perhaps the most important right reserved to the stockholders.

As has been stated the stockholders cannot manage the affairs of their corporation directly, but only through the board of directors. This board is not amenable to either request or resolution of the stockholders and has wide latitude and great independent power in the management of the corporate affairs and property unless expressly restricted by special charter or by-law provisions. Special charter provisions are of limited application and not always available, and therefore in most cases the wishes of the stockholders as to the management of their property and business must be expressed in the by-laws and can be effectively expressed in no other way. For this reason anything affecting the stockholders' sole right to make, repeal and amend these by-laws is a matter of vital importance.

In New Jersey, and those other states which have modeled after her corporation laws, the charter may be so worded as to give the directors power to make and amend by-laws. This gives them the power to alter the regulations by which they themselves are controlled. The expediency of such a proviso is exceedingly doubtful, even in the large industrial combinations for whose benefit it was contrived.

Its tendency is to put much power into the hands of the directors, and of the majority stockholders by whom such directors are elected, and to correspondingly diminish the status and power of the minority stockholders.

In New York, the directors are, by statute provision, given the power to adopt any desired by-laws not inconsistent with those passed by the stockholders. This would seem to be quite as far as it is safe to go. It allows the directors to pass necessary by-laws to meet an emergency, or some unforeseen condition, and they are fully within their powers so long as these by-laws do not conflict with the by-laws adopted by the stockholders. They cannot, however, remove any of the safeguards thrown round the conduct of the business by the by-laws of the stockholders, nor modify them in any material respect. They may act in harmony with what has gone before, but cannot alter or destroy. It is to be noted that such directors' by-laws, until repealed or superseded by action of the stockholders, are the by-laws of the company and of equal force with those adopted by the stockholders. (See § 108.)

§ 129. **Arrangement.**

By-laws intended for a close corporation with but few stockholders and perhaps all these on the board of directors, may be simple in form and few in number.

When intended for a large corporate combination with many plants in different states, with hundreds or thousands of stockholders scattered throughout the Union, with a large directorate, many officers and numerous managing committees, an extensive and comprehensive set of by-laws is essential.

In either of these cases, and for the many intermediate corporations, it is of much advantage to have the by-laws classified and systematized so that the regulations governing any particular subject or matter may be readily found. In all the better prepared sets of by-laws this systematic class-

ification is employed. In many cases, however, the by-laws are hardly more than a heterogeneous jumble of unconnected regulations.

The arrangement of by-laws followed in the present volume under which the related provisions are grouped in the order and under the headings given below is used by a number of the best-organized corporations of the country and has proved very satisfactory in practice.

1. Stock.
2. Stockholders.
3. Directors.
4. Standing Committees.
5. Officers.
6. Dividends and Finance.
7. Sundry Provisions.
8. Amendments.

By-laws from the simplest to the most comprehensive sets may be readily classified on these lines. (See Forms 8, 9 and 10.)

§ 130. Preparation.

The adoption of by-laws is the first important step of corporate organization. It is essential in order to give a basis for the proceedings that follow.

As the by-laws are needed so early in the corporate existence, they are customarily prepared in advance of the first meeting, this duty usually and properly falling to the counsel conducting the organization of the corporation.

The preparation of a set of by-laws for the usual small corporation is a comparatively simple matter. For the larger corporations, with their more complex and extended organizations, the undertaking is much more difficult. Such by-laws should be prepared with nice adaption to the needs of the particular corporation. The use of an existing set of by-laws as a basis for this work is entirely proper and good practice, but such selected set should be carefully

studied and skillfully adapted to the wants of the new corporation. All unnecessary matter should be dropped, the matter that is retained be made to fit the case in hand, and such new matter added as may be necessary to cover the requirements.

Too often the preparation of the by-laws of a new corporation is merely a wholesale seizure of some existing set with hastily improvised interpolations to meet the most obvious needs of the new organization. These by-laws may have been a very admirable code of procedure for the original corporation, but so diverted can hardly fail to be a wretched misfit and prove a fruitful source of trouble. By-laws so ill-prepared give seeming grounds for the demand that the directors be given the power to amend by-laws as the only means of avoiding serious hindrance and injury to the business.

§ 131. Adoption of First By-Laws.

The formal adoption of the first set of by-laws is accomplished by the reading of each section and its adoption by vote, followed by the adoption of the set as a whole at the completion of the sectional consideration. As it is usually impossible to prepare by-laws at this first meeting, or to properly discuss and amend a previously prepared set, the responsibility for the by-laws rests almost entirely with the lawyers to whom their preparation is entrusted. As a matter of fact, the by-laws are usually presented to the meeting in their entirety, and, without reading or other investigation of their details, are either adopted by formal vote, or accepted by acquiescence. The legal effect of such adoption is the same as under the more formal procedure. (See § 192.)

By-laws varying as to scope and application are given in Chapter XLIII of the present volume as Forms 8, 9, and 10. As has been stated, these by-laws are all arranged on the same general plan, each subject in its various phases being found in

the same relative position in each set. The comment of the following chapters conforms to the same logical order and is intended to be considered in connection with the forms of by-laws there given.

CHAPTER XXIII.

STOCK.

(See Art. I in Forms 8, 9 and 10.)

§ 132. Preliminary.

Formerly it was customary to begin the by-laws of a corporation with a section setting forth the name of the corporation and the amount of its capital stock. While there is no serious objection to this, such facts seem almost too fundamental in their nature to require repetition in the by-laws and are now generally omitted.

Also in former days when preliminary subscriptions to the stock of a corporation were usual, and in many cases payable in instalments, a by-law provision as to the payment of these instalments and the procedure in case of default was customary and of some importance. In the present day, however, the formation of a corporation with instalment subscriptions is comparatively rare, and when it does occur, collection of the subscription is usually provided for by resolution of the directors. This avoids cumbering the by-laws with matter that is of no permanent utility.

The subject of stock which is considered first in the following comment is one of the most important matters of by-law regulation. In most of the states, the general rules relating to the stock of the corporation, its certificates, its transfers and records, are matters of statutory regulation. These statutes should be summarized and classified in the by-laws and such additional special regulations brought in as will cover the entire working details of the subject. No open question should

be left as a foundation for later differences of opinion, vexatious disputes, and, perhaps, more serious difficulties.

§ 133. Certificates of Stock.

Every holder of stock for which the corporation has been paid in full is entitled to a certificate or certificates, showing the number of full-paid shares of stock held by him. A subscriber when his subscription is accepted, becomes a stockholder of the company and entitled to vote and draw dividends if any are declared, but is not entitled to a certificate of full-paid stock until he has paid the full subscription price of his stock. If he has paid in part he is entitled to a receipt evidencing such payment, and if the by-laws so provided, or if the corporation made a practice of issuing certificates for partly paid stock with the amount of payments indorsed thereon, he would have a right to demand such a certificate as soon as his first instalment was paid. In the absence of such by-law provision or of such a custom, it does not appear that a stockholder would have any legal right to a stock certificate until he had paid in full for the stock represented thereby. It would be the better practice to issue no certificates of stock until the stock represented by them was full-paid.

The holder of a certificate of stock has the right to assign the same, or to surrender it and have it split up or issued to himself in certificates of different values. The assignee has the same right and whenever a duly assigned certificate is surrendered to the company, a new certificate or certificates must be issued to the assignee in his own name if so demanded. All these matters should be clearly set forth in the by-laws.

By-law specifications as to the signature and sealing of certificates are useful as prescribing in detail the execution of the certificate and the duties of the different officers concerned. Such by-law regulations must, as a matter of course, follow any statute provisions. For instance, in New Jersey the treasurer must join with the president in signing the stock certificates. In most states, this matter is discretionary and the proper offi-

cers to sign stock certificates are designated solely by the by-laws. No matter who the signing officers may be, the sealing and actual issuing of the certificate is usually left to the secretary. (See § 44.)

§ 134. Transfers of Stock.

General regulations regarding the transfer of stock as well as the times of closing the stock books, are in many states a matter of statutory provision, but would also properly appear in the by-laws with any other connected matter. The whole procedure should be plainly outlined in the by-laws as a guide to the officers of the corporation, and, more particularly, for the benefit of the stockholders who are thereby informed as to their exact rights in the matter.

§ 135. Transfer Agent and Registrar.

In the larger corporations, or in any corporation where the transfers of stock are numerous, the employment of special transfer agents and registrars is usually a considerable advantage. By this means the officers are relieved of much responsibility, and the general plan offers a safety and a convenience in the issuance of stock not secured under any other arrangement. For a small or close corporation and where transfers are few, the employment of such agents is a needless expense.

Where these agents are to be employed, the by-laws should give the appointing power to either the board of directors or one of the standing committees. The by-law provision covering this matter should also require the signature of the transfer agent and of the registrar to every certificate issued. Where a trust company is to be appointed as transfer agent or registrar and the appointment is of probable permanence, such appointee is sometimes named in the same by-law provision. As this necessitates an amendment of the by-laws in case of any change, the arrangement is of doubtful expediency.

The duties of transfer agent and registrar are distinct but are usually performed by one person or institution.

§ 136. Stock and Transfer Books.

In the matter of stock and transfer books, the statute laws must be carefully consulted. New Jersey corporations are required to keep their stock and transfer books in the principal office of the corporation in New Jersey. If it is desirable that duplicates be kept elsewhere the by-laws might properly so provide. Every foreign corporation doing business in New York is compelled to keep a stock book in the principal office of the company in the state. Hence the by-laws of a corporation organized under the New Jersey laws and doing business in New York might very well specify in this particular the duties of the corporation in both states.

If the closing of the transfer books before the date of the annual meeting, with its election of directors, has not already been provided for in the by-law relating to the transfer of stock, it should receive attention here. Also any proviso as to the closing of transfer books before dividend days might be included under this head.

§ 137. Preferred Stock.

The preferred stock of a corporation will probably have been specifically provided for in the charter. It is customary, however, to repeat such provisions in the by-laws for easy reference and for the information of the stockholders. As all the details relating to preferred stock are usually found in the charter provisions by which such stock is created, the by-law will be merely a more or less complete repetition of the charter specifications. In some few states preferred stock is authorized by the provisions of the by-laws which in such event become of much more moment and should be drawn with the same care and regard for the necessities of the case as would any charter provision. The by-law authorizing the issue of preferred stock could not be materially altered or amended after stock had been

sold under its terms except with the consent of the holders of the outstanding preferred stock. If it were modified without such consent, the changes would be ineffective as regards this outstanding stock unless accepted by its holders. (See Chap. VIII, Preferred Stock.)

§ 138. Treasury Stock.

This subject is brought into the by-laws merely to define the term and the status of the stock designated thereby. Such a by-law is advisable if the corporation is likely to have any stock of the kind. The term "treasury stock" is used very loosely, and, without some defining provision, ambiguities are apt to arise.

The status of this treasury stock is, where not expressly fixed by statute, a matter of common law, but should nevertheless be clearly expressed in the by-laws as a matter of information for both officers and stockholders. (See Chap. X, Treasury Stock.)

§ 139. Lost Certificates.

The loss of stock certificates is a matter of not uncommon occurrence and the procedure in such cases should be clearly outlined in the by-laws. Stockholders have a right to certificates and, if their certificates are lost, to have them replaced, but the corporation on its part has the right to require any reasonable safeguards for its own protection before the reissuance of such certificates. If the statutes prescribe the procedure to be followed, the by-law provision must correspond. It is seldom wise to reissue lost certificates on easier terms than those laid down in the by-law forms given. Only the absolute and final loss of a certificate, as in the case of its unquestioned destruction by fire, would justify an unprotected reissue.

CHAPTER XXIV.

STOCKHOLDERS.

(See Art. II in Forms 8, 9 and 10.)

§ 140. Annual Meetings.

An annual meeting of stockholders at which directors for the ensuing year are elected is usually required by the statutes. Where not so required, such meeting is usually provided for in the by-laws. It is the most important function of the stockholders and the portion of the by-laws devoted to the stockholders is principally occupied with topics pertaining to the annual meeting.

The by-laws providing for the annual meeting should fix the time, place, and, in a general way, the proceedings of that meeting. This specification of the business to be transacted at the annual meeting does not in any way limit the proceedings thereat unless expressly so stated in the charter or by-laws. Such enumeration is merely to prevent important action being omitted or overlooked, and it is expected that in addition any other business or matters of interest to the stockholders will be considered at this annual meeting.

§ 141. Special Meetings.

The by-laws must provide for special meetings of the stockholders, and fix the preliminary requirements for such meetings. Frequently the president is given authority to call special meetings at his discretion; it is always customary to provide for such meetings to be held pursuant to resolution or other specified action of the board; at times it is provided that

a certain number of the directors may call special meetings by a written request or call; it is also customary and proper to allow these special meetings to be called on demand of a certain proportion in interest—usually one-third or a majority of the outstanding stock.

It is usual to prescribe in the by-laws that only such business as is specified in the call and notice shall be transacted at a special meeting of stockholders. This is a matter of common law, and in some states, statutory law, and is included in the by-law merely to emphasize the fact that any business to be done at any such meeting must be previously notified to the stockholders. The call and notice, to be sufficient, must give the three essential facts—the time, place and purpose of the meeting. If any one of these is omitted, the meeting is improperly called and its action is liable to be held illegal and of no effect.

§ 142. Officers of Meetings.

It is customary in some corporations to organize each stockholders' meeting with officers of its own choosing, who may or may not be the regular officers of the corporation. Under some conditions this plan may be a wise one, but, generally, it would seem better to provide in the by-laws that the officers of the corporation shall also be the officers of the stockholders' meeting. In such case, the president, or, in his absence, the other officials in due order, would preside, while the secretary would keep the records of the meeting. Such an arrangement saves much confusion and loss of time on occasion, and conduces to the orderly transaction and proper record of the business of the meeting.

The secretary is, under this arrangement, properly omitted from the officials who may preside. The function of this officer is to record the proceedings of the meeting and it would not be advantageous to withdraw him from his proper duties to preside, even though all the other officers were absent.

§ 143. Notice of Meetings.

Unless there is some material reason for not so doing, it will be found advantageous to adopt the same requirements as to notice for both regular and special meetings. In such event, these requirements may be properly included in the one by-law. Where the notices for the two kind of meetings differ materially, the details for each meeting should occupy a separate by-law section.

The notice of regular meetings should specify the time, place, and, usually, the most important objects of the meeting. As stated in 2 Cook on Corporations, §595,

> "where unusual business is to be transacted, even at a regular meeting, the notice of the meeting should state that unusual business."

The notice for special meetings should give the time and place of meeting and specify in detail all the business to be acted upon at that meeting.

Where a corporation has but few stockholders, the provisions as to notice of meetings will sometimes add, that, with the presence and participation or with the consent of all the stockholders, meetings may be held at any time and place and for the transaction of any business, without notice.

Notice of meetings is best given through the regular postal channels; telegraphic notice is, in the larger corporations, usually provided for; personal notice is allowable, but should always be served in writing. A verbal notice is usually difficult, and sometimes impossible, of proof.

§ 144. Voting.

The usual rule in regard to voting is that each stockholder of a corporation is entitled to one vote for each share of stock standing in his name on the books of the corporation. If there are any variations, such as cumulative voting, classified voting, or reservation of voting to one class of stock, such variation should be stated as clearly as possible. Perspicuity

and precision in the by-laws relating to voting may save much trouble later. Such provisions must, as a matter of course, conform to any state statutes on the subject.

§ 145. Certified List of Stockholders.

Under the laws of New Jersey and of some other states, certified lists of the stockholders entitled to vote thereat must be provided by the secretary at each regular meeting of the stockholders. In such states a provision to this effect should be incorporated in the by-laws either as a separate section, or as a part of the by-law providing for annual meetings of the stockholders. In any state the provision is a satisfactory one and may well be included in the by-laws. It is to be noted that where, as is usually the case, the statutes provide that the stock books shall be the final authority as to the right of any stockholder to vote, the certified list of stockholders cannot be made a substitute for the stock book. Usually, however, it saves reference to the stock book and is much more convenient than this latter record.

§ 146. Election of Directors.

As the election of directors is the most important business of the annual meeting, directions for its conduct should be very explicit. If, as is the case in certain states, the statutes require the election or appointment of inspectors, sworn to the proper discharge of their duties, the details of their appointment and duties should be fully outlined. If inspectors are not prescribed by statute and are not desired, some other method of conducting the election should be specified. It is usually advisable that it be by ballot, though this is not essential unless prescribed by statute. If by ballot, provision must be made for the appointment of tellers or some substitute therefor to collect, count and announce the vote.

Unless included in the by-law on voting, any provisions as to cumulative voting, or as to classification of the stock in regard to voting, should be given here. Also, if the directors

are classified so that but one-third or one-fourth are elected each year, such fact should be stated under this heading.

The term for which the directors are elected should also be stated clearly. Usually this is for the ensuing year and until the election of their duly qualified successors. The directors hold until the election of their successors in any event, but the by-laws should state the fact.

§ 147. Quorum.

In a number of the states, the proportionate amount of the outstanding stock which must be represented at a meeting to constitute a quorum is fixed by statute. In such case the by-laws can do nothing more than repeat the law in order that it may be remembered and observed. If the statutes do not so provide, the quorum should be distinctly prescribed by the by-laws. If not provided by either statute or by-law, the common law rule would prevail that the stockholders present, no matter how few their number, constitute a quorum.

In the absence of any statutory provisions, the by-laws may provide that less than a majority of the outstanding stock shall constitute a quorum, but for most corporations it is not safe to depart from the usual parliamentary rule that a majority of the stockholders in interest are necessary for a quorum.

To illustrate the necessity of a careful consultation of the statutes in matters of corporate procedure, it may be noted that in New York the by-laws may prescribe the number necessary to constitute a quorum for ordinary business, but cannot fix a quorum for the election of directors, those present at any annual meeting being a sufficient quorum for this purpose no matter how few their number or how small a proportion of the outstanding stock they represent.

It is to be noted that the common law rule that those present constitute a quorum and may elect, applies only to the constituent membership of a body, such as the stockholders of a corporation. The directors, being a selected body, require a majority of the entire board to constitute a legal quorum.

(1 Morawetz, 2d Ed., § 476; 2 Kent's Com., § 293; Matter of Rapid Transit Ferry, 15 App. Div., N. Y., 530, 1897.)

§ 148. Proxies.

Proxies play such an important part in all corporate meetings that the by-law provisions affecting them should be clear and explicit. At common law the right does not exist. It is created by statute in many states, and elsewhere may be authorized by charter provision, or in most states by by-law enactment. Where created by statute, the by-law provision must follow the statute.

The statutory provisions in regard to proxies vary considerably in the different states. In Maine the proxy must have been executed within thirty days preceding the date of meeting; in Massachusetts the limit is six months; in New York it is eleven months; in New Jersey three years. If not affected by statutory provisions, a proxy would run until revoked or terminated by the sale of the stock by the owner, by his death or by the death of the proxy.

§ 149. Order of Business.

The order of business is purely formal but quite essential to the proper transaction of the corporate business. It may be varied to meet the needs of any particular corporation. The order given in the by-law forms indicates the usual and logical arrangement. The formal order of business may be suspended at any meeting, in whole or in part, by a majority vote of those present, or by their mere assent.

CHAPTER XXV.

DIRECTORS.

(See Art. III in Forms 8, 9 and 10.)

§ 150. General Considerations.

Any regulations affecting the directors and any restrictions upon their powers and actions will, for the most part, appear only in the by-laws. Specially important matters sometimes appear in the charter, but in the main the stockholders must look to the by-laws to direct and control the operations of the directors.

Much latitude is allowable in the arrangement of the by-laws affecting directors. In the larger corporations the subdivisions are frequently carried further than here indicated; in the smaller corporations, ordinarily, not so far.

Many of the details appearing in the by-laws affecting directors are matters of law, or are fixed by charter provision and are brought into the by-laws merely to save reference to the authorities from which they are taken.

§ 151. Number and Qualifications.

In many states the number of directors is, within certain limits, fixed by statute. In other states, as New Jersey and Massachusetts, the minimum only is prescribed by statute and any number in excess of this minimum may be fixed by the by-laws. In most states the minimum number of directors allowed is three.

For a small or close corporation a limited board of directors is usually advantageous. Such a board is easily assembled, keeps in touch with the business, and is generally prompt in consideration and action.

In the larger corporations a more numerous directory is usual. Frequently this is a matter of necessity in order to provide representation for the different stockholding interests as well as to have the really necessary managing representatives upon the board. Though necessary the arrangement has many disadvantages. A quorum is only secured with difficulty, the members are not close to the business and are not interested actively in its management, and lengthy explanations, much discussion and prolonged consideration are the rule when important questions are really taken up. As a result, the actual management of the business and of the corporate affairs generally is delegated to the standing committees, the board only meeting to listen to reports, or to act in matters of exceptional importance. (See Chap. XXVI, Standing Committees; also § 110.)

The ownership of stock as a qualification for the directory is usually regulated by statute. In some states such qualifying stock must be owned when the director is elected. In most states, if the director-elect is given or secures stock after his election, the requirements of the law are held to be satisfied. If the statutes merely state that directors must be stockholders the ownership of one share of stock is sufficient. If the statutes are silent on the subject of stock qualifications of directors, or if they merely require that directors be stockholders the by-laws may legally provide that some reasonable number of shares shall be the qualification.

In some states it is provided that a director parting with his qualifying stock thereby, *ipso facto,* ceases to be a director. In order to prevent any discussion or misunderstanding on this point, the by-laws should repeat the statute provision where it exists. Elsewhere it would be prudent to state explicitly either that the parting with the qualifying stock does or does not terminate the director's tenure of office. As a general rule it would seem advisable that directors should be stockholders of the corporation to some material extent, and that if they part with this qualifying stock they should by such disposal sever their official connection with the board.

If there is any statutory requirement as to citizenship of directors it should be included in the by-laws. (See § 105.)

§ 152. General Powers.

At common law the directors have entire charge of the property and affairs of the corporation with full power and authority to manage and conduct the same. The statement of the by-laws to this effect is, therefore, nothing more than a reiteration of the conditions as they exist, brought in as a matter of information. If the powers of the directors are materially modified or restricted by the charter or by-laws, the by-law statement should correspond.

§ 153. Classification.

The usual object of a classification of directors is to provide against any radical action or sudden alteration of policy that might occur if the whole board were changed at one time. In perhaps the greater number of states it must be secured through by-law provision.

To be effective, any such classification of directors must be permanent and therefore, wherever possible, should be by charter provision. If dependent only upon the provisions of the by-laws, a majority of the stockholders might at any time assemble with due formality, repeal the by-laws in question and thereby abrogate the whole arrangement. (See § 109.)

If classification is provided by charter or by-law provision, and at any time the necessity arises for a complete change of the board, as in event of a sale of the entire stock, or of a generally desired change of management, the matter can be arranged by the resignation of the entire membership of the old board *seriatim*, the new members being elected to fill each successive vacancy as it is brought about by these resignations.

Classification in a small or close corporation is generally a useless and somewhat troublesome formality.

§ 154. Vacancies.

Unless so provided by statute, charter, or by-laws, the board of directors has no power to fill vacancies caused by the resignation or death of its members. In such event the power is reserved to the stockholders and any vacancies in the board must either wait until the next annual meeting with its election of directors, or be filled by a special election, the stockholders being called together for the purpose. (*In re* Griffing Iron Co., 63 N. J. Eq., 168, 357, 1899.)

As long as the board can assemble a quorum of its entire membership it may continue to act despite vacancies, but it is safer to keep the membership up to the prescribed quota, and it is almost an invariable rule to give the board the power to fill vacancies as they occur. In this way the board is self-perpetuating in the intervals between the annual meeting.

The by-laws might properly provide that continued absence from meetings of the board would, of itself, vacate the position of such absentee director. In any such case the by-law should specify the exact number of consecutive absences from regular meetings, or from regular and special meetings, necessary to create a vacancy.

By-laws also sometimes provide that in case the membership of the board falls below the required quorum at any time, so that the board is unable either to transact business, or to fill the vacancies in the body so as to enable it to act, a special meeting of the stockholders shall be called to elect such number of directors as may be necessary to restore the board to its normal membership.

§ 155. Meetings.

The frequency of regular meetings of the board is to be decided by the particular conditions. Monthly meetings are usual, but in close corporations with a small board it is often unnecessary to meet regularly more than once in each quarter, or even once each year. In case of any emergency requiring

action of such small board, a special meeting can be quickly and easily called.

The nature and formalities of the call necessary to summon a special meeting of the board are purely matters for the corporation to determine. Usually the president is given authority to call such meetings at his discretion. Generally it is provided also that such meeting shall be called upon written request of a certain number—usually two-thirds—of the directors. More rarely it is provided that a special meeting shall be called upon the written request of a certain proportion in interest of the stockholders.

Where the board is small it is customary and advisable to provide that meetings may be held at any time and place and without previous notice by the unanimous consent, or unanimous participation of the board membership. Such a provision would usually be useless if the board were large.

The place of meeting should be fixed by the by-laws though a proviso may be added that special meetings may be held elsewhere by unanimous consent of the board. The office of the corporation is the proper place for directors' meetings and they should be held there unless otherwise agreed by all the directors. To allow a majority of the board to call meetings in private offices, or in places difficult of access, or to permit of adjournment to such places, except by unanimous agreement, is to invite the gravest abuses.

§ 156. Notice of Meetings.

It is supposed that members of the board are familiar with the date of regular meetings. Hence, there is not the same legal necessity for notice that exists in the case of special meetings. It is usual though to provide that notice of regular meetings shall be given by the secretary as a matter of convenience and to prevent such meeting from being overlooked. In the more comprehensive sets of by-laws it is customary to add a proviso that failure to give such notice shall not affect the validity of the meeting or of any proceedings thereof. (See

Form 10.) It is not probable that proceedings in a regular meeting of directors would in any case be invalidated on account of failure to give notice, but the proviso is added out of abundant caution.

Special meetings unless adequate notice thereof has been given, are not legally called and their action may be set aside. Requirements as to notice may, however, be waived and special meetings be held without notice by unanimous consent, or with the participation of all the directors. Business of any kind may be transacted at any meeting if all the directors have given written consent thereto or are participating in the proceedings.

Notices of special meetings of directors are usually sent by either mail or telegraph such reasonable time before the meeting as will, under ordinary conditions, permit the attendance of all the members of the board. The by-laws should prescribe the condition of such notice. The by-laws also usually reiterate the common law rule that no business except that specifically notified in the call and notice shall be considered or acted upon at special meetings.

§ 157. Quorum.

If the statutes are silent as to the number of directors requisite for a quorum, the charter or by-laws will control. If both the statutes and the charter and by-laws are silent, the common law controls and a majority of the full membership of the board is then requisite for a quorum.

If the matter is regulated by the by-laws any desired number may be designated a quorum even though this number may be much less than a majority of the board. It is customary and advisable, however, to require a majority of the entire board to constitute a quorum. Under such provision, any reduction in the membership of the board by death, removal or resignation, would not affect the number requisite to a quorum, which still remains the same. The by-law should be carefully worded to avoid any misunderstanding on this or other points. As a matter of general law the statement

might be included in this by-law that directors must appear in person and cannot be represented by proxies.

§ 158. Election of Officers.

The by-laws should designate the officials of the corporation, the time of their election and the period for which they are elected. It is also usual to provide that they shall hold office until the election and qualification of their successors, unless sooner removed by action of the board. It is also usually specified that election shall be by ballot, and that the board shall fix the compensation of officers and fill any vacancies that may occur on the official staff.

In arranging the respective dates of the stockholders' annual meeting at which the directors are elected, and the meeting of the directors thereafter at which the officers are usually elected, the latter meeting should not succeed the former so closely as to give inadequate time for the notification of newly elected directors. Frequently such directors' meeting will be arranged to follow the stockholders' meeting on the same day, but a few hours elapsing between the two meetings. If the board be small and any possible new members readily accessible, or if the entire membership be re-elected the juxtaposition of the two meetings is immaterial. Where, however, these conditions do not exist, it may occur that some newly elected member of the board fails to receive notice of his election, and of the subsequent directors' meeting, in time to permit of his attendance. This might prevent the election of officers or invalidate it if held. For this reason the board meeting for the election of officers should, as a rule, be fixed at such date subsequent to the annual meeting as will give full time for the regular by-law notice of the board meeting.

It is customary and entirely proper to fix the date of the election of officers within a reasonable time after the election of the board in order that this new board may without delay elect its own corps of officers.

§ 159. Removal of Officers.

If an officer is elected for a specified term he cannot usually be legally removed except for sufficient cause, and not then until he has had opportunity to appear in his own behalf. In a few states the power to remove officers at pleasure is given the directors by statute. Otherwise, if it is desired that the board shall have this power of removal, it should be clearly conferred on them by the by-laws. The by-law giving the power should be explicit and to be effective should provide for removal at pleasure with or without cause. If such power of removal is given the directors by the by-laws, each officer accepts his office subject to this regulation, knows upon what tenure he holds and may thereafter be removed at the pleasure of the board by a mere majority resolution. (See § 177.) (See Douglass *vs.* Merchants Ins. Co., 118 N. Y., 484, 1890; in re Griffing Iron Co., 63 N. J. Eq., 168, 357, 1899.)

§ 160. Compensation of Directors.

Directors cannot claim any salary or compensation for their services as directors other than is expressly set forth in the by-laws. Definite salaries might be fixed, but compensation is usually provided in the form of a certain stipend for attendance upon meetings, which is not earned unless the director is present at the entire meeting from roll call to adjournment. The amounts paid for attendance at meetings vary, rarely falling below $5 or exceeding $25. Sometimes a certain fixed sum is appropriated for each meeting and is divided among the directors present. The whole matter is one that rests entirely in the discretion of the stockholders and would naturally vary in different corporations.

§ 161. Power to Pass By-Laws.

In many of the states the directors are, by statute, given extensive powers over the by-laws. Elsewhere it is a matter

for charter or by-law regulation. It is doubtful whether it is wise in any case to allow the directors full power—as may be done by charter provision in New Jersey—to over-ride by-laws passed by the stockholders. The only direct control of the stockholders over the affairs of the corporation is exercised through the by-laws, and if the directors can repeal and abrogate these by-laws at will the board is practically unrestrained in its management of the corporate affairs.

At times it is undoubtedly advantageous that the board should have some power over the by-laws in order to provide for matters or emergencies not foreseen by the stockholders. All necessary power in this direction is, however, given when the board is allowed to pass by-laws in harmony, or not inconsistent with those passed by the stockholders. Anything further is dangerous and susceptible of abuse. (See §§ 73 and 108.)

§ 162. Order of Business.

The order of business is a purely formal regulation. A convenient arrangement is given in the sets of by-laws in Part VII. The order of business, although incorporated in the by-laws, is not mandatory, and any item may be passed or the entire regular order of business may be suspended or varied at the pleasure of the board.

CHAPTER XXVI.

STANDING COMMITTEES.

(See Art. IV in Form 10.)

§ 163. Purpose.

In most of the larger corporations the board of directors is composed of many members. Usually these are busy men, possibly living in different parts of the country and almost always difficult to assemble. Many of them are on the board not because of peculiar qualifications or ability in the conduct of the particular corporation business, but solely as representatives of special interests. Under such circumstances the board is not an efficient instrument for the direction of the corporate affairs and something better adapted to the purpose is necessary. The standing committee is then usually employed.

Standing committees are permanent committees of the board of directors as opposed to committees of the board appointed for temporary purposes. They frequently exercise all the powers of the board. They are a natural outgrowth of the extension of the corporate system to the larger enterprises in which unwieldy boards are commonly found. The slow, cumbrous and uncertain action of these large boards is replaced by the prompt, positive and efficient action of a small, selected committee.

The membership of the standing committees is seldom less than three or more than five. To increase the membership of standing committees too greatly would involve the very ills that they were created to avoid. As many standing committees may be appointed as the conditions demand.

In many cases the executive committee alone is found sufficient. In others a finance committee is added. It is but seldom that more are necessary. These committees practically take the place of the board in the direct management of the corporate affairs.

If the executive committee is the only standing committee, it is usually given all the powers of the board, and becomes the active agent by whom these powers are exercised. If there is a finance committee, such matters as come within its purvey will be reserved from the powers of the executive committee, and the two committees will then between them exercise all the powers of the board. In such case the executive committee will control in all general matters, while the powers of the finance committee will be confined to the management and supervision of the corporate finances.

These standing committees, appointed with such powers, are the real managing bodies of the corporation, the board merely supervising their operations. They will usually act and then report their action to the board. In some cases where they prefer to throw responsibility upon the board, or where some statute provision requires action of the board, or when it is desirable to lend added weight to a contemplated measure, they will report the matter to the board with a recommendation that the desired action be taken.

It is to be noted that at times an executive committee is provided when the board itself is sufficiently small to permit of prompt action and proper attention to the corporate business. In such case the committee may become directly injurious to the real corporate interests, the few members composing it managing the entire business of the corporation to the practical and improper exclusion of the board. In such cases the directors, as a body, usually lose interest, board meetings are neglected and the executive committee controls without supervision.

The only danger to be apprehended from the employment of the standing committee is found in the fact that it is at times used as a convenient means for the elimination of the board, or certain elements of the board, from control of the corporate affairs, the real management of the corporation being placed in the hands of the selected few who constitute the committees. This danger can only be avoided by careful definition and judicious regulation of the powers of these committees in the charter or by-law provisions by which they are created. (See 2 Cook on Corporations, § 715.)

§ 164. Appointment.

The standing committees are usually created and empowered and the manner of their appointment or election is prescribed by charter or by-law provisions. Since the powers of the board are to a greater or less degree to be delegated to these committees they must be composed of members of the board. The provisions as to their appointment are therefore confined to the manner of their selection from this body. Sometimes the creating provision will provide that certain officials of the board shall constitute the standing committees, as for instance that the president, vice-president and treasurer shall constitute the executive committee. Generally the treasurer is designated as a member of the finance committee. Also it is quite usual to provide that the president of the company shall *ex officio* be a member of the executive committee and sometimes it is provided that he shall be a member and the presiding officer of all standing committees. At times it is provided that the president shall appoint the different standing committees. The most common, and perhaps the safest plan, leaves the membership of these committees to be decided by an election in the board.

If there is any danger of the committees being used as a device to exclude minority interests from management

of the corporate affairs, such majority of the board may be prescribed for the election of their members as to require the aid of the minority for their formation. A provision of this kind might result in a dead-lock, but in that case the board would continue in the direct management of the corporate interests until some agreement was reached and acceptable standing committees elected.

There is no general rule as to the appointment or selection of officers for the standing committees. In some cases they are designated by the creating provisions, in others they are elected by the board, while in many cases the selection of officers is left to be decided by each committee for itself. It is probably simplest and most satisfactory to provide that the chairman of each committee shall be designated by the board. The only other necessary officer is the secretary. At times it is provided that the secretary of the corporation shall also act as secretary of the committees. If, however, there is more than one standing committee, and especially if these committees are active, it may be found advantageous for each committee to have a distinct recording official who may or may not be a member of that committee.

§ 165. Composition.

The membership of the standing committees must be confined to the membership of the board, otherwise the power of the board to delegate its authority to the committees would be more than questionable and the action of such committees of doubtful legality.

Within this limitation, the standing committees should be formed on the principles of specialization. Those most familiar with the corporate business and most capable in its practical management will naturally be grouped in the executive committee. Those of most skill and standing in financial matters will properly be selected for the membership of the finance committee. Other considerations fre-

quently intervene to prevent this ideal formation of the standing committees but the more nearly it is approximated the better will be the practical results.

The creating provisions not uncommonly provide that the president, vice-president and treasurer, with or without additional members, as may be desired, shall constitute the executive committee. These officers being elected by the board to the positions they already occupy, are presumedly men of executive ability, familiar with the corporate affairs and therefore peculiarly qualified to act as members of the managing committee. On the other hand such appointment adds materially to the responsibility, the power and the importance of these official positions and may for that reason at times be unadvisable.

The treasurer should obviously be a member of the finance committee unless special reasons to the contrary exist. If a member of the finance committee he should not ordinarily also act on the executive committee.

§ 166. Powers.

There is no doubt that the board may legally delegate its authority to properly constituted standing committees. (The Sheridan El. L. Co. *vs.* The Chatham Nat. Bank, 127 N. Y., 517, 1891; Olcott *vs.* Tioga Railroad Co., 27 N. Y., 546, 1863). This delegated authority may be co-extensive with the powers of the board in the interim between board meetings, or may be limited to certain specified actions or lines of action. The extent of the power to be delegated to the standing committees is usually fixed by the charter or by-law provisions by which the committees are created, though it may be left to be determined by the board itself. If the powers of the standing committees are fixed by the creating provisions the board can not delegate powers in excess of those prescribed.

The creating provisions frequently go into detail as to the powers and duties of such committees. These powers

should not be too extended and the committees should be required to keep full and adequate written records of their proceedings. These records should be open to inspection by members of the board, and frequent reports to the board should be required.

Properly constituted and empowered, and within the limits of their authority, the standing committees act with the same binding force and effect as would the board itself. Their contracts are not affected by any subsequent disapproval of the board nor can the corporation refuse to carry out any of their proper undertakings.

§ 167. Procedure.

The standing committees act as do other parliamentary bodies. Their usual officers are a chairman and secretary, and these officers perform the usual duties. Regular meetings may be provided for by the by-laws with full provision as to their conduct and record, or the matter may be left to be regulated by the committees as seems to them best. Owing to their compactness and the manner in which they are usually constituted, the standing committees are easily assembled and a large portion of the business of such committees is usually accomplished in special meetings, either regularly called or assembled by unanimous consent.

All special meetings should be duly notified to the members, and the consent or participation of every member must be secured to consent meetings; decisions reached and action taken should be expressed in duly adopted resolutions and minutes should be kept containing a faithful record of all committee proceedings. These proceedings should from time to time be reported to the board, either by direct report, or by the reading of the committee minutes. Vacancies in the committees should be filled in accordance with by-law provisions, usually either by the committee itself, or by action of the board, except in the case of an ex-officio member, who succeeds to his position on the

committee by virtue of his election to official position in the corporation.

A majority of the executive committee, unless otherwise expressly provided, constitutes a quorum and a majority of that quorum has power to act. It may be prudent to provide that the affirmative vote of a majority of the whole committee shall be necessary for action. This does not necessitate any increase in the number necessary to a quorum, but if a mere common-law quorum be present requires the affirmative vote of all the members present to secure action.

CHAPTER XXVII.

OFFICERS.

(See Art. IV in Forms 8 and 9; also Art. V in Form 10.)

§ 168. Enumeration; Qualifications.

The term officers is here applied to those agents of the corporation appointed or elected—usually by the board of directors—as the direct executive representatives of the board and of the corporation. The directors are themselves at times styled officers, and with legal correctness, but to avoid confusion the term is not so used in the present volume.

The details relating to the officials of a corporation are matters of by-law prescription. The statutes are usually silent in the matter, the charter seldom takes cognizance of anything pertaining to the corporate officials, and the by-laws control.

Under these circumstances the stockholders as the by-law making power have wide discretion. They fix the number, titles, qualifications, duties, method of election and all other details relating to the officers, and their wishes as expressed in the by-laws, prevail. If not covered in the by-laws such matters are regulated by common or parliamentary law or custom.

The necessary officers of a corporation are the president, secretary and treasurer. In the smaller corporations two of these offices are sometimes held by one person. In most cases, however, the number of officers is increased by the addition of one or more vice-presidents, a managing director

or general manager, and at times a chairman of the board, counsel and an auditor. The officials named are, for the most part elective, and, with the occasional exception of the general manager, are supposed to report directly to the board or to one of the standing committees. Outside of committee officials, other agents and employees are not usually designated officers and but seldom come in contact with the board.

The election of officers naturally follows closely on the election of directors and is usually held as soon thereafter as the newly elected board can be properly assembled.

The president and vice-president are chosen from the board itself as they may be called upon to preside at its meetings. This is not necessary in regard to the other officers, though the treasurer is frequently chosen from the membership of the board, and other officials are so selected when convenient. The treasurer of the larger corporations is usually selected on the basis of his financial standing or ability. It would seem obvious that the corporate officials should all have special qualifications and a knowledge of the duties of their positions, though other considerations frequently prevail.

§ 169. Presiding Officers.

The president is the usual presiding officer. His duties vary widely according to the size and character of the corporation. In the smaller corporations he is frequently assigned the active management of the business in addition to the duties more strictly pertaining to his office. In the larger corporations the duties incident to the president's office are frequently allotted in greater or less degree to other officers. If a chairman of the board exists, that official presides at all meetings of the board. If there is a chairman of the finance committee, he takes over the supervision and direction of the financial matters usually assigned to the president. At times certain of the duties ordinarily

pertaining to the president are performed by the vice-presidents.

The utility of a chairman of the board is, in most cases, doubtful. Where the office exists, its duties should be clearly defined by the by-laws. If a chairman of the board be provided, the general rule that the president must be a member of the board is not so imperative, though even then as the chief executive of the company he should be present at board meetings, must almost of necessity participate in its discussions and deliberations and should therefore be a member of the body.

Vice-presidents, designated and ranked as first, second, third and so on, may be provided for in accordance with the corporate needs. These perform the duties of the president in the absence of that official, or of the ranking official, in the order of precedence. In addition, in the larger corporations, active functions are usually provided for several vice-presidents. Frequently their number is swelled merely to afford honorary positions for members of the board. In the smaller corporations, the duties of the vice-president are sometimes assigned to the treasurer, or this latter is elected as vice-president and treasurer. (See § 142.)

The presiding officers of the standing committees are usually provided for either by the by-laws or by action of the board, but are sometimes left for the committees to elect. The president of the company is usually president of the executive committee; the treasurer is frequently placed at the head of the finance committee.

§ 170. Secretary.

The duties of the secretary should be fully and explicitly prescribed in the by-laws, especially as to signatures. He would naturally have charge of the corporate seal and affix and attest it when necessary, though the president is occasionally authorized thereto as well. Unless the statutes, as

in New Jersey, call for the signatures of the president and treasurer to stock certificates, the secretary is often designated to sign such certificates with the president. He generally has entire charge of the details of the issue and recording of stock. The corporate records are entrusted to him, and the various state reports are usually prepared by him. His powers and duties as to signing contracts are entirely dependent upon the by-laws or conditions of the particular corporation. Usually he signs with the president, but frequently the president signs alone, or with the treasurer, or the matter is decided in each important instance by resolution of the board. When his signature is not affixed to sealed contracts, it should appear on such instrument in attestation of the seal.

§ 171. Treasurer.

The treasurer is usually given full charge of the corporate finances and all that immediately relates thereto; also the custody of all corporate instruments and evidences of value. He signs all checks, with or without the president as the by-laws or directors may prescribe, and participates in the execution of all the instruments pertaining to the financial transactions of the corporation. The by-laws should clearly define the extent of the treasurer's powers and responsibilities.

Whenever the treasurer's position involves the handling or possession of large sums of money, or of considerable property values, he should be required to give bond. In a small corporation, or one where the responsibilities of the treasurer are light, such requirement is an unnecessary formality.

The finance committee, if such a committee exists, takes on itself many of the duties and responsibilities of the treasurer, and, unless that official is chairman of the finance committee, renders his position much less onerous.

§ 172. Managing Officers.

The position of managing director is only found in the larger corporations, and the position and duties of this official are often somewhat indeterminate. In some cases his duties are practically those of the general manager; in others he is given much of the power and many of the duties of the president. At times, the position is in the nature of a compromise, the duties of the managing director being carved out from those of the president and general manager.

The position of managing director is supposed to be more dignified than that of the general manager. Its duties should be clearly prescribed by the by-laws, in order to prevent possible conflicts of authority. This is the more necessary, as the duties of the position are not so definite or well understood as those of the other officials and custom cannot be referred to for missing details.

The general manager is only accounted an officer of the company—in contradistinction to the employees—because he is selected by and usually reports to the board. His position generally differs materially from that of the other officials. At times he is instructed to report and act under the direction of the president. If the by-laws did not specifically provide for the election of a general manager, the board would have authority to appoint or employ such official and prescribe his duties and salary, just as they might employ any other necessary agent or employee of the company. In such case the usual laws and customs relating to the contract of employment would control.

§ 173. Counsel; Auditor.

In the larger corporations counsel is usually retained as a regular and permanent feature of the management. Such official has no original powers, even his control of litigation being subject to the direction of the board, or, if it be so referred, to one of the standing committees.

In the smaller corporations by-law provision for counsel is not usual, the board being left to employ counsel at such times and on such terms as it may deem expedient. The employment of counsel then becomes merely a matter of contract.

The compensation of counsel is usually fixed at some minimum amount, which is considered a retainer, any further payments depending upon the services rendered.

The auditor is usually an essential officer of the larger corporations. Where the work that may properly be referred to the auditor is not sufficient to justify his regular employment, the by-laws may provide for periodical audits, or the whole matter may be left to the discretion of the board. Where the volume of corporate business is at all large, the employment of an auditor or some provision for suitable audits of the corporate books and accounts is a wise precaution.

§ 174. Assistant Officers.

The president is usually well provided with assistant officers in the vice-presidents. The treasurer is frequently materially assisted by the personnel of the finance committee. Where this is not the case, and sometimes in addition thereto, an assistant treasurer is not unusual. In the larger corporations an assistant secretary is frequently appointed.

Such official duties as the board may deem expedient are delegated to these assistant officers, or their duties may be prescribed at discretion by the officials they assist. In any event, the by-laws should clearly prescribe their status and manner of appointment. If these assistant officers are to perform the duties of their principals in the absence of these latter, the by-laws should so prescribe.

In the smaller corporations assistant officers, outside of the vice-presidents, would be an unnecessary and possibly complicating addition to the corporate mechanism.

§ 175. Delegation of Official Powers.

Exigencies may arise in which it may be desirable or even necessary for one official to exercise the powers and perform the duties of another, in whole or in part. The board would have authority to temporarily delegate the powers of certain officers under such circumstances without special by-law provision, but to save question and possible trouble, the power, if likely to be necessary, should be specifically conferred by the by-laws. One official could not delegate his powers to another, even temporarily, in any material matter, unless specially authorized thereto by the by-laws or action of the board.

§ 176. Salaries.

Officers are distinguished from employees by the fact that unless it is specified that they are to receive salaries they are not, as a rule, entitled to charge for their official services. Neither is it ordinarily legal for the directors to vote a salary for such services after they are performed. To avoid misunderstanding, however, it should be clearly stated in the by-laws, either that the officers of the corporation shall receive no salaries, or that the officers shall receive only such compensation for their services as the board may designate at the time of their appointment, or the salary attached to each office may be specifically stated. The whole matter is one to be adjusted from a business standpoint and much trouble is likely to be saved by a definite arrangement. (See Henry Woods Sons' Co. *vs.* Schaefer, 173 Mass., 443, 1899; Met. El. R. Co. *vs.* Kneeland, 120 N. Y., 134, 1890; Ellis *vs.* Ward, 137 Ill., 509, 1890; Kilpatrick *vs.* Penrose F. B. Co., 49 Pa. St., 118, 1865.)

If, however, such an officer is neither stockholder nor director of the company and stands in no relation which would make it his interest to serve without compensation, there will be a *prima facie* obligation to pay him. (Smith *vs.* Long Island R. R. Co., 102 N. Y., 190, 1886.)

§ 177. Removals; Vacancies.

The power of removal and the filling of vacancies is usually provided for in the by-laws under the head of "Directors," as already discussed in Section 159. It would be proper, however, to repeat any powers given the board in this direction, in a short by-law under the heading of officers, or the ground might be covered by a reference to the by-law by which this power was conferred. If the occasion arises for the exercise of the power of removal, or it becomes necessary to fill a vacancy, there should be no possible basis for any doubt or question as to the authority of the directory to act.

CHAPTER XXVIII.

DIVIDENDS AND FINANCE.

(See Art. V in Forms 8 and 9; also Art. VI in Form 10.)

§ 178. **General.**

All those provisions directly relating to the financial management of the corporation will be grouped in the by-laws under the general heading of " Dividends and Finance." Any limitations on the control exercised by the directors over the finances of the corporation, and any directions as to the management of these finances, must, unless incorporated in the charter, appear in the by-laws. If this is not done the directors are in complete control, except in so far as they may be restrained by statute law.

It is to be noted that any restrictions on the salaries of officials, if of a general nature, would appear in the by-laws relating to finance. If the amount of each official salary were fixed, such limitations might appear in these by-laws, but would also be included in the by-laws relating to the respective officers.

§ 179. **Dividends.**

The by-law provisions on this subject are for the most part merely declaratory of the common or statutory law on the subject. Their inclusion in the by-laws is very desirable, not only on account of the importance of the matter, but because the statutory or common law provisions against illegal dividends are otherwise frequently overlooked or disregarded.

§ 180. Reserve Funds.

Under the laws of most states the directors have full power, unless otherwise provided by charter or by-laws, to set aside any portion or all of the profits at their discretion as a reserve fund or for the purpose of accumulating a working capital. In New Jersey, on the contrary, the directors, unless otherwise expressly authorized by charter or by-laws, must annually distribute all the corporate profits as dividends. Such compulsory distribution of profits might at times be prejudicial and even disastrous to the corporate interests, and, accordingly, it is usual in New Jersey to authorize the accumulation of a reserve fund by charter or by-law provisions.

In other states the matter of reserves is sometimes left entirely to the discretion of the directors, but usually the matter is regulated by suitable provisions. The minimum reserve fund to be maintained will be prescribed in which case no dividends must be paid while the reserves are below this minimum, or a stipulated annual dividend will be required from the annual profits before anything is passed to the reserve, or a certain percentage of the annual profits will be passed to the reserve fund. Whatever the arrangement it should be so clearly expressed as to admit of no misunderstanding.

§ 181. Limitations of Debt.

By-law restrictions upon the power of the directors to incur debt are at times employed. These limitations are of various forms. At times the debt incurring power of the board will be limited to a stated gross amount which must not be exceeded without special authorization by the stockholders; or it may be provided that such limit of indebtedness shall not be exceeded unless authorized by a specified majority of the directors, as a two-thirds vote of the entire board, or perhaps by unanimous action of that body. Occasionally the board will be restricted as to the amount of any

one contract or obligation, as for instance that no contract or obligation involving liabilities of more than $2,000 shall be entered into or incurred by the board unless specifically authorized thereto by resolution of the stockholders.

The advisability of such limitations is open to question. Peculiar cases will undoubtedly arise where such restrictions are desirable, and at times they are necessary, but as a general rule it would seem better to elect a responsible board rather than to attempt restraints upon its action. (See §§ 107, 116, 117, 236 and 243.)

§ 182. Bank Deposits.

The by-law provisions as to the corporate bank deposits are important and should be very explicit in their terms. They should prohibit absolutely any irregular retention or disposition of the funds by the treasurer, and provide that all moneys coming into his hands be promptly deposited in the name of the company. This latter point should be covered specifically by the by-laws, as the occasional practice of allowing deposits to be made in the individual name of the treasurer, or in his name as treasurer, is a standing invitation to irregularities and resulting trouble.

The by-laws should also prescribe the signature to corporate checks. Practice varies as to this matter but unless there is reason for doing otherwise checks should be signed with the company name, affixed by the treasurer and verified by his signature, with, usually, a countersignature affixed by the president.

The by-laws relating to bank deposits should cover the ground fully and clearly, leaving nothing to the discretion of the board or finance committee save the designation of the depositaries.

CHAPTER XXIX.

SUNDRY PROVISIONS.

(See Art. VI in Forms 8 and 9; also Art. VII in Form 10.)

§ 183. General.

Under this head will come all those by-laws that cannot be included under the titles already discussed and that are too few or unimportant to justify separate classification. Some of these matters are of particular application. A few are of general application, are found in all complete sets of by-laws and are considered in the following sections of the present chapter.

§ 184. Corporate Seal.

It is customary to prescribe the details of the corporate seal in the by-laws, the provision being usually so worded as to serve as a formal adoption of the described seal. This seal usually gives the corporate name, the year and the state of incorporation. These are customary, but not essential, as any other wording or device, if properly adopted, would be the legal seal of the corporation. Any additional designs, mottoes or ornamentation may be added as desired and will neither add to nor detract from the legal effectiveness of the seal.

§ 185. Penalties.

The enforcement of by-laws by means of penalties is of doubtful utility. Cases may arise where penalties may be profitably employed, but usually such measures are futile and inadequate. Where the power of removal exists, persistent disregard of the by-laws by officials of the corporation would

undoubtedly be proper grounds for the exercise of this power. If such power is not given by the by-laws or statutes, official disregard of the by-laws would probably be sufficient reason for a removal on common law grounds. If the directors act in disregard of the requirements of the by-laws, such action is illegal, and the personal liability that may follow is a much more effective penalty than anything that could be inflicted by direct by-law provision.

§ 186. Amendments.

The usual by-law provision on this subject requires majority action of the stockholders for amendment of the by-laws. This conforms to the provisions of the common law. Where greater stability is desirable, on account of special provisions incorporated in the by-laws, or generally, as a protection to minority interests, it is sometimes provided that two-thirds in interest, or even a larger proportion of the stockholders, must vote in favor of any amendment before it is effected.

Such provisions, merely made part of the by-laws, unless reinforced in some way, are of but little avail. The majority have the right to amend and repeal the by-laws, and it cannot be taken from them by a mere unsupported by-law inhibition. (Smith *vs.* Nelson, 18 Vt., 511, 1846.)

Such a provision, to be effective, must either be incorporated in the charter, or, if in the by-laws only, must be so established and confirmed by vested rights accrued under it as to have become in effect a contract between the corporation and the stockholders, and, therefore, unchangeable, except in accordance with its own provisions. The New York Court of Appeals in Kent *vs.* Quicksilver Mining Co., 78 N. Y., 159 (1879), said:

> "A private corporation cannot repeal a by-law, so as to impair rights which have been given and become vested by virtue of the by-law; and this although the power is reserved by its charter to alter, amend or repeal its by-laws."

This is stated yet more strongly in Loewenthal *vs.* Rubber Reclaiming Co., 52 N. J. Eq., 440, a case where stock had been sold on the strength of the safety afforded by special charter and by-law provision:

> "The certificate of organization and the by-laws contemporaneously adopted, constituted a contract between the stockholders and the corporation, and it is not competent for the legislature to authorize either to be changed without the consent of all the stockholders, except it be done in the mode provided by the by-laws themselves." See also Mills *vs.* Cent. R. R. Co., 14 Stewart Eq., 1.

It is worthy of note, that it has been decided in Pennsylvania that the by-laws cannot be amended by a majority of the stockholders at an annual meeting in any important particular, such as an increase of directors, unless the notice of that meeting informed all the stockholders that such action was contemplated. (Bagley *vs.* Reno, etc. Co., 201 Pa. St., 78, 1902.)

PART V.—ORGANIZATION OF CORPORATION.

CHAPTER XXX.

FIRST MEETING OF STOCKHOLDERS.

§ 187. General.

In the great majority of the states procedure for the organization of a corporation is uniform as to the main features. First, the charter is prepared and is executed by the incorporators; next, this duly executed charter is filed with the officials prescribed by statute, then the meeting of incorporators is held, by-laws adopted, directors elected and such other action taken as may be necessary. The directors then meet, elect the officers of the corporation and its organization is complete.

In a few states, however, this procedure is practically reversed, the election of directors and officers and adoption of by-laws preceding the filing of the charter. In other words, the by-laws are adopted and directors and officers elected before the corporation has any legal existence. The arrangement seems somewhat illogical, but is prescribed by the statutes of certain states and in those states must be followed. It merely amounts to a preliminary determination of these details, of no force unless the charter application is allowed, but then becoming automatically effective and binding on the new corporation. This variation of the usual procedure is found in Maine, Massachusetts and some other states. In these states the proceedings outlined in the present and following chapters must be modified to meet the statute requirements.

Under the customary procedure, after the charter application has been duly submitted for approval and filing in the office or offices designated by the statutes, and after such approval and filing has taken place and been notified to the incorporators, these latter are authorized to assemble and perfect the organization of the new corporation.

The incorporators or their proxies are the only persons entitled to act at this time. Their power to call the first meeting and to act thereat for the corporation is derived from the recognition and express authorization given them by statute. If their subscriptions are set forth in the charter itself each incorporator votes at this first meeting in accordance with such stock subscription. In those states where the first meeting is held before the charter is granted, each incorporator is usually entitled to one vote in the organization meeting.

There may be numerous subscribers to the stock of the new corporation who are not named in the charter, but their subscriptions not having as yet been accepted by the new corporation, the subscribers, as such, are not stockholders of the corporation and are not entitled to any participation in its affairs until after express acceptance of their subscriptions.

Unless there is some good reason to the contrary, the number of incorporators is usually fixed at the minimum allowed by the statutes. This is done purely as a matter of convenience and as simplifying the formalities preliminary and incident to the first meeting.

Where the number of incorporators is small, the first meeting is most conveniently assembled by means of a written call and waiver of notice, which must be signed by all the incorporators. This call and waiver must fix the time and place of meeting, and should also specify the business to be transacted thereat, though, by reason of all the interested parties signing, so much particularity is not necessary as in the call for the usual special meeting. A blanket phrase consenting to the transaction of any and all business brought before the meeting is in this case allowable and authoritative. Such a call and

waiver, to be effective, must be signed by every incorporator. It need not be issued or signed any definite time before the meeting, as it is a waiver of all statutory requirements of notice. A meeting so called and properly conducted is legal in any state of the Union. (Braintree, etc. Co. *vs.* Braintree, 146 Mass., 482, 1881.)

Where for any reason the call and waiver of notice cannot be used, any form or method of procedure prescribed by the statutes for the assembling of the first meeting should be followed to the letter. If no form is prescribed by the statutes it will be necessary for a majority of the incorporators to unite in a call for the first meeting. This call must fix the time, place and business to be transacted at the meeting, and must be served on the other incorporators a reasonable time before the date of meeting. Any convenient place of meeting may be selected, the time of notice must be sufficient to permit all the incorporators to be conveniently present, and the business to be transacted should be set forth in detail. The meeting is practically nothing more than a special meeting of the stockholders, and, in the absence of statutory prescription, its notice should follow the general rules in regard to notice for special meetings.

§ 188. Preparation of Minutes.

The first meeting of stockholders, and usually the first meeting of the directors as well, are of the cut and dried order. The incorporation has been undertaken for a specific purpose and usually by certain people, who have already settled among themselves just how the corporation is to be organized in all main details. The organization meetings are merely a formal execution of these prearranged plans. It is, therefore, customary to have the minutes of these first meetings written out in advance and often with much particularity. The advantages of the plan are found in the orderly procedure thereby outlined, the better presentation of the matters to be considered and the inclusion of all matters that ought to be considered. If any-

thing occurs at or during the time of the meeting to modify the minutes as already written, the necessary changes are quickly made by erasure or interlineation and no confusion need result.

§ 189. Method of Conducting Meeting.

The manner of conducting the first meetings varies widely with the conditions. In certain cases, where everything is settled in advance, and is to be kept in the precise shape determined upon, the entire minutes are put in final shape before the time of meeting. Then the attorney, or other party having the incorporation in hand, after due assembling of the incorporators, reads to them these cut and dried minutes as the proceedings of the meeting. With the assent of those present, or in the absence of express objection, the minutes so presented are declared to be the minutes of the meeting, which is thereupon adjourned. The minutes are then transcribed in the minute book, are signed by the parties respectively mentioned in the minutes as the presiding officer and secretary and the matter is closed. The directors' meeting is conducted in the same perfunctory manner and with the same precision of result.

This method though informal and irregular cannot be said to be illegal. The presence of all the parties in interest and their assent and active participation, acts to estop them from objecting to the proceedings and no one else would have the right to object.

It is needless to say that when this method is employed the incorporators are generally dummies, who, after the completion of the organization, step aside and make way for the real parties in interest.

When the exact proceedings of the minutes are to be carried out, but the attorney in charge is unwilling for it to be so purely a matter of form, the minutes will be read but the parties named therein will go through the indicated motions. Thus if the minutes state that the charter is pre-

sented by the president, or chairman, a copy of the charter will be handed the party named in the minutes as the presiding officer and the minutes verified by its due presentation to the meeting. Likewise the parties named as making and seconding motions will be asked if they make and second such motions, their ready assent usually verifying the predictions of the minutes to a nicety. Also as each motion is reached in the reading, the meeting will be asked if it favors such motion, the assent of the meeting usually being readily obtained. Such a meeting is much less of a legal fiction than the meeting conducted entirely by the reading of the minutes and is to be preferred.

Where the real parties in interest participate in the first meetings the proceedings are not usually of such a perfunctory nature. The minutes then serve more as a detailed order of business and are varied as the needs of the occasion seem to indicate. The presiding officer really presides, the secretary performs his functions, motions are made and any elections actually take place, discussions are in order if the necessity arises, and, in short, the assemblage is a meeting intelligently acting, and not a collection of dummies, useful only as pegs upon which to hang the prescribed proceedings.

In the comments which follow, it has been taken for granted that the actions of the meeting are to be really taken.

§ 190. Opening the Meeting.

At the duly appointed time and place, the incorporators, or a majority of them, having assembled, some one of those present will call the meeting to order, and, in the absence of objection thereto, will call on some other incorporator present to take the chair. If there should be any objection to the appointee, or to the selection of a chairman by appointment, the party calling the meeting to order would let the matter be decided by vote. The chairman, as soon as his appointment or election is announced, will take charge

of the meeting and, if there is no objection thereto, appoint some one present to act as secretary. The secretary will then note the names of those present and ask for the proxy of any one of the incorporators not present in person. It is desirable to have all the incorporators represented at this first meeting, though a majority in interest could legally act.

The secretary should now produce proper evidence that the meeting has been duly called and this evidence should be ordered spread upon the minutes. If the meeting has been assembled by call and waiver signed by all the incorporators, such call and waiver should be produced and ordered entered in the minutes of the meeting. If called by publication, copies of the newspapers in which the notice appeared would be adequate evidence. If called by notice served personally or by mail, a copy of the notice should be presented accompanied by a certificate of the party by whom it was served that such service was duly effected. If the meeting assembled in any other way, the procedure and the evidence that it had been properly carried out should be laid before the meeting and should appear in the minutes.

§ 191. Reception of Charter.

The chairman or secretary should now produce a copy of the certificate of incorporation, and report the fact and date of its allowance and of its filing in the office or offices required by the statutes. Motion should then be made that the certificate of incorporation as presented be accepted or received and spread upon the minutes as a part of the record of the meeting.

It is not essential that this copy of the charter be certified by the Secretary of State, though such certified copy is customarily procured and is generally more satisfactory to the interested parties than an uncertified copy. The charter is entered preferably on the first pages of the minute book, followed by the by-laws, with the other instruments that are made part of the record following the minutes

proper, each beginning at the head of a page. So arranged, these instruments are much more easily found and referred to than if incorporated and buried in the body of the minutes. Also the minutes themselves are clearer and more intelligible if not broken up by the interjection of the lengthy instruments ordered spread upon the minutes. The legal effect of the entry of these instruments in the way indicated, if so ordered by the meeting, is exactly the same as if they appeared in the context.

§ 192. Adoption of By-Laws.

The by-laws will usually have been prepared in advance of the first meeting and have been fully considered by those interested. At the time of the meeting, they are presented, read article by article by the secretary or by such other party as may be requested thereto by the presiding officer, and adopted as a whole. At times each article will be adopted as read, followed by the adoption of the by-laws as a whole, though this is not a necessary formality.

If serious objection is offered to any of the by-law provisions, such objection will be taken under consideration by the meeting and any proposed modifications settled by formal action. As the time at this first meeting is, however, usually fully occupied with routine procedure, such matters cannot be given the consideration they deserve and any objections or suggestions in regard to the by-laws should be discussed, and, if possible, settled before the meeting.

Where the by-laws have been fully considered by the interested parties in advance of the meeting and all are familiar with their provisions, the reading of the by-laws may, either by unanimous consent, or by formal motion, be dispensed with and the by-laws adopted as presented and as a whole. The reading of the by-laws before adoption is, however, the safer plan, preventing any unauthorized substitutions with possible resulting disagreement later as to just what was adopted.

§ 193. Election of Directors.

In most of the states the election of directors properly follows the adoption of the by-laws, such election being the only method by which the directors may be properly designated and empowered. In New York and in some other states, however, the directors for the first corporate year are named in the charter. In such case no action in regard to the directors is necessary at the first stockholders' meeting, the board being already in existence with full power to take up and manage the affairs of the corporation. If the incorporators do not meet at this time, the board would, pending such meeting, of necessity, be forced to adopt by-laws of more or less completeness. To avoid any such contingency and to avoid other possible inconvenience, it is the better practice in these as in other states to have the stockholders meet prior to any meeting or action of the board.

Where directors are to be elected at the incorporators' meeting, any statutory directions must be followed exactly and the minutes should show in detail that this has been done. In the absence of statutory provisions, an election by ballot, conducted by tellers appointed by the presiding officer would be legal and proper. In such case the meeting would be the judge of the qualifications of voters, each incorporator or other participant voting according to the number of shares of stock subscribed for by him. If an agreement exists as to the parties to be elected as directors, these parties might be nominated by the meeting and the secretary by motion instructed to cast the vote of the meeting for the parties so nominated.

§ 194. Exchange of Stock for Property.

The board of directors is the proper and final authority to conclude an exchange of stock for property. Where, however, as is often the case, a large proportion or possibly all the stock of the corporation is to be issued in pay-

ment for some particular property, it is customary and advisable to have the proposed purchase sanctioned and authorized by express action of the stockholders. Such action if unanimous commits all the stockholders to the purchase, and estops any participant from later objection to the transaction.

The proposal for exchange of stock for property is usually presented to the meeting, read, discussed if desired, and then a resolution passed approving the proposed purchase, referring it to the directors and instructing them to consummate the same. (See Chap. XXXII, Issuance of Stock for Property.)

§ 195. Other Business.

Usually there will be other business to come before the stockholders at this first meeting depending upon the conditions surrounding the particular corporation. In some states specific action is required of the stockholders by the statutes. If there is any action to be taken by the directors in which there is doubt of their power, or some advantage to be gained by an authorization from the stockholders, the necessary action should be taken at this time. Beyond this, however, it is not advisable for the stockholders to go. All matters of general management are in the hands of the board and any uncalled for action in regard thereto on the part of the stockholders can have no advantageous results and may embarrass the proper action of that body.

CHAPTER XXXI.

FIRST MEETING OF DIRECTORS.

§ 196. General.

In the majority of the states, the directors of a new corporation are elected at the first meeting of stockholders, and, of necessity, the first board meeting is held subsequent thereto. Even in those states where by charter appointment of the board, that body might meet in advance of the first meeting of stockholders, the general practice is for the meeting of stockholders to precede the first meeting of the board.

At their first meeting the stockholders usually adopt by-laws. The board in its first meeting has therefore the guidance of these by-laws so far as they may apply. As the first meeting of the board is not a regular meeting, it is governed by the by-law provisions relating to special meetings, except as variations are made necessary by the unorganized condition of the board at this time.

No secretary having as yet been elected, the meeting cannot be called or assembled as it otherwise might but must either be assembled by a call signed by a majority of the members of the board, such call being in its general form similar to the usual call for special meetings and complying in every way with its requisites, or otherwise, and as is usually done, the meeting must be brought together by a written call and waiver of notice, which must be signed by all the members of the board. This instrument should specify the time and the place of meeting, and give in detail the various matters to be considered and acted upon. If the stockholders have selected any office or definite headquar-

ters for the new corporation, the meeting of the directors would naturally be called for that place, if not, any convenient place would be proper. The most important matters for consideration at this meeting are the election of officers, the issuance of stock for property—where this is to be done —and the authorization of any proceedings necessary to the commencement of business. A blanket provision permitting the transaction of any and all business pertaining to the affairs of the corporation should be included in the call and waiver. Signed by the entire membership of the board this provision would be effectual and would permit action on any corporate matters that may come up for consideration. At times this latitude of action is of considerable advantage.

§ 197. Minutes.

As in the case of the stockholders' first meeting, the proceedings of the first meeting of directors may usually be anticipated and minutes be prepared in advance with considerable accuracy. Occasionally in such case, the minutes are prepared in permanent form and the proceedings conducted in accordance by a mere reading of the minutes—their adoption as the minutes of the meeting being signified by silent acquiescence, by express assent or by a more particularized assent on each important point as the reading progresses. Usually, however, the prepared minutes are used more as memoranda, the meeting at least going through the motions of transacting the outlined business.

It is hardly necessary to say, that "cut and dried" minutes should not be prepared or used where there is any probability of a difference of opinion in the board. Courtesy would forbid, even if there were a decided majority in favor of the outlined action. Also, speaking generally, it would neither be politic nor advisable to ignore so openly the consideration and deliberation which should in any case of disagreement be characteristic of board action.

§ 198. Opening the Meeting.

When the board assembles in its first meeting it is unorganized and must therefore be called to order by some one of its members, who, on his own volition, or at the request of other members, takes the initiative. This member merely calls the meeting to order, and, in the absence of objection, names a temporary chairman or presides until a temporary chairman is appointed or elected by the meeting. This latter then takes the chair and a temporary secretary is at once appointed or elected. This completes the temporary organization of the board.

The call, or call and waiver, or other authorization under which the meeting has assembled, should then be presented to the meeting, and, if it appears that the meeting has been duly assembled, the evidence thereof should be ordered entered on the minutes. In the absence of objection this might be so ordered by the presiding officer, otherwise by formal action. As the meeting is a special meeting it is important that it shall have been properly called and that due record be made of this fact.

A roll call, or its equivalent, the recording of those present by the secretary completes the opening formalities and the meeting is ready for business.

§ 199. Election of Officers.

If, as is almost invariably the case, the officers of the corporation are to be elected by the board, their election is the first business before the meeting. The by-laws already adopted by the stockholders should designate the officers to be elected and the manner of their election, and these requirements should be strictly followed. Generally the election is by ballot. Candidates for the various offices might be severally nominated with due second thereto, but, as usually the candidates for the various offices have been agreed upon in advance, formal nominations are dispensed with and the details of election taken up at once. Where all are agreed, a

motion is frequently passed instructing the secretary to cast the single ballot of the meeting for the recited list of officers. This is proper, and, at times, convenient.

If the election is to be carried out in detail, the presiding officer will, in the absence of objection, appoint tellers. The members of the board then prepare their respective ballots and the tellers collect and count these ballots and announce the results. Each officer may be balloted for separately, or, as is usually the case, one ballot be made to serve for all the officers.

Immediately after the election the newly-elected president and secretary, if present, will take charge of the meeting and assume their respective official duties. If, however, these officials-elect are absent, or if anything prevents their immediate assumption of their duties, the temporary officers will continue to act until the close of the meeting, unless the permanent officers sooner take charge. If, as in New Jersey, the secretary is required to be sworn, he should comply with this requirement before acting in his official capacity, though his failure so to do would not vitiate his records, nor affect in any way the legality of the meeting.

§ 200. Adoption of Stock Certificate.

The stockholders may, if they so desire, either by resolution or by-law provision, adopt a form of stock certificate. The matter is one, however, that, on account of its nature, is usually left to the discretion of the board. Frequently temporary certificates are adopted, to be replaced later by more elaborate permanent certificates. Changes of conditions may occur necessitating change in the certificate originally adopted. Other contingencies affecting its form not infrequently arise. For these and other reasons the matter is one best handled by the board.

Frequently a form of stock certificate will have been selected and possibly printed or engraved before the time of the first board meeting. Even if this be so, the selected form

should be formally adopted and either the secretary be authorized and instructed to procure the necessary books of stock certificates, or, if the books have already been procured, such action be ratified and the books as presented be accepted. The resolution by which this is effected should also authorize the secretary to provide a seal, minute book and such other corporate books and stationery as may be required.

The form of seal is customarily determined in the by-laws which have already been adopted by the stockholders. If this is not the case the form of seal should be selected and adopted by the directors.

§ 201. Acceptance of Subscriptions.

Subscriptions made by the incorporators of a new company need no formal acceptance. The mere fact of their having executed the charter, in which their subscriptions usually appear, and of having participated in the organization meetings obviates the necessity of acceptance. If there are other subscribers to the stock of the new company, such other subscriptions require formal acceptance. This is accomplished by resolution of the board of directors. Such acceptance completes and makes binding the contract between the corporation and those who have offered to take its stock. Neither party can then recede and the subscribers, by this acceptance, become stockholders of the corporation and entitled to all the rights of stockholders. The issue of certificates to these stockholders does not usually take place until their subscriptions are fully paid and then is only a convenient method of evidencing their status not affecting their rights as stockholders one way or the other. If they do not fulfil the conditions of subscription their stock may be forfeited, but until that time their rights are in full existence.

The acceptance of subscriptions is followed by such action in regard to the payment thereof as may be necessary. If part or all of the subscription price of the stock were due

on acceptance, the treasurer of the company would be empowered to collect the amounts due. If, as in New Jersey, thirty days' call, unless waived by the subscribers, must be made before any part of the subscription price of stock can be collected, either the board would instruct such call to be issued, or, as is usually done, would secure a waiver of this condition by the subscribers and take immediate steps for the collection of the amounts then due.

If the corporation has been organized with the minimum amount of subscriptions permitted by the statutes and additional subscriptions are necessary, or desired, the proper officers of the corporation would be instructed to offer for sale or subscription such portion of the capital stock as is to be sold. Such action would be governed entirely by the conditions of the particular corporation.

§ 202. Exchange of Stock for Property.

If, as is almost invariably the case with business corporations of the present day, all or a portion of the corporate stock is to be issued in exchange for property, the matter is usually brought before the first meeting of the board by the submission of a formal written proposition for the exchange. This is usually accompanied by a resolution of the stockholders approving the exchange and instructing the directors to accept the proposition. These matters are usually presented with proper explanations by the presiding officer, but may with entire propriety come through the secretary. Usually the proposition is ordered received and spread in full upon the minutes of the directors' meeting. If already in the stockholders' minutes this would not be necessary, but preferably the proposition should be reserved to appear in the directors' minutes in connection with the final action taken thereon.

Usually such a proposal calls for little discussion as the matter has already been fully considered. The presentation and formal disposal of the documents in the case is there-

fore generally followed by a formal resolution of acceptance. This resolution should briefly recite the conditions, specifically accept the proposition, and instruct the officers to take the necessary steps to consummate the transaction. It should also authorize the proper officers to issue the stock consideration and deliver it against the delivery of the duly assigned property for which it pays. (See Chap. XXXII, Issuance of Stock for Property.)

§ 203. Financial Provisions.

In all cases where a bond is required of the treasurer, such instrument should be submitted to the board and formally approved by it before the treasurer assumes the active duties of the office. As the treasurer is usually agreed upon before this first meeting of the board, it will be possible and entirely proper for him to have the form of his bond and the name or names of his proposed sureties ready for submission at the first convenient interval in the board proceedings after his election. The form and sureties of the bond, if approved, will be accepted, and the instrument after execution be entrusted to either the president or secretary for safe keeping. The treasurer will then at once enter on his duties.

The by-laws should already have provided that the funds of the corporation be deposited in some bank or trust company, or one or more of these institutions as may be necessary and as may be designated by the directors, such funds to be drawn out only by check signed usually by two designated officers of the corporation. It now devolves upon the board to select the corporate depositary. Such selection should be expressed by resolution which should be furnished the selected institution at the time of opening the account. The copy of the resolution furnished the bank should be certified by the secretary, and the names of the officers authorized to sign checks and the form of signature should also be certified to the bank. Often the banks have their

own special forms for such resolutions of corporate depositors. In such case, the resolution would conform to the bank's requirements.

§ 204. Other Business.

Many matters of lesser importance will be brought up before the first meeting of directors depending upon the particular conditions. Authority may be needed to rent and furnish suitable offices for the new corporation. In some states provision must be made for a state agent and office. Various statutory requirements must be fulfilled. Certain certificates and reports may need authorization. Details of the general business require consideration.

If the matters requiring attention cannot be all properly considered at this first session of the board, adjournment should be taken to the next day or to some other convenient date. Such adjourned meeting is considered as merely part or a continuation of the original meeting and may re-assemble at the appointed time without formality and complete its work. If on the other hand the board adjourned without date, it could only be re-assembled—prior to the next regular meeting—by the methods prescribed in the by-laws for the calling of special meetings.

Matters requiring the attention of the board are usually so numerous in the first days of the corporate existence that it is a wise precaution—even if not necessitated by business actually on hand—to adjourn the first meeting over a few days. Then, if necessary, such adjourned meeting may be held. If not necessary, the members need not attend and the meeting will lapse, the effect being then exactly the same as if the board had adjourned without date at the first meeting.

CHAPTER XXXII.

ISSUANCE OF STOCK FOR PROPERTY.

§ 205. General.

The great majority of modern corporations issue their capital stock in whole or in part in payment for property. This practice gives rise to many questions of more or less complexity, varying with the circumstances of each particular transaction.

Financial and trust institutions are generally forbidden to issue their stock for anything but cash, hence questions as to the full payment of their stock or the legality of its issue rarely arise.

Also, in the many cases where corporations are organized to take over prosperous businesses, large estates, patents of proved value or other properties of substantial worth, difficulties are not likely to occur, there being in such cases little if any temptation to over-capitalize the corporations or over-value the property taken in exchange for stock.

In perhaps the majority of incorporations, however, the property acquired is of speculative or unascertained value, as a mining claim, an untried invention, a new process or a going concern. Also such incorporations are usually under the direction of optimistic promoters, who capitalize largely and take over the properties at valuations so generously elastic as to nominally full pay the stock issued, no matter what its amount. These are the cases that give rise to litigation.

Questions as to the validity of a stock issued, or of the full payment therefor, rarely rise so long as the corporation is prosperous or even solvent. Under such conditions, few, if any, would have the right to bring these matters up, or, having the right, would care to do so. If, however the corporation

becomes insolvent and any doubt exists as to the proper payment of the stock issued, the question rises promptly, and usually the receiver or some creditor institutes suit to compel the stockholders to pay the difference between the real value of the property received by the corporation and the par value of the stock issued therefor. The point upon which a suit of this kind hinges is the alleged fraudulent overvaluation of the properties taken over.

Such a suit could only be instituted by dissenting stockholders, by creditors of the corporation or by its receiver. As such transactions are usually carried through at the inception of the undertaking and with the knowledge and consent of all existing stockholders, the holders of this consenting stock would be estopped from legal action, and if all the stock of the corporation were included in such issue, suit could then only be brought on behalf of creditors. Generally speaking, these latter would have to be subsequent *bona fide* creditors who had given credit in ignorance of the real conditions, otherwise they would have no right of action.

Usually, any alleged overvaluation of the property taken by the corporation in payment of its stock would be a question for a court of equity to decide. In case it were found that the property had been fraudulently overvalued the stock issued against such property might be held as but partly paid, and the holders called upon for such additional payments as would make up the full face value of the stock. This liability would not extend to purchasers of stock if their purchases were made in ignorance of the conditions of issue, no matter what prices were actually paid by them for their stock.

In the present consideration of the issuance of stock for property, reference is made solely to original issues at the time of organization of the corporation. Property may be received in exchange for stock after organization, but in such case another factor, the rights of existing stockholders, enters in, and, though the general principles are the same in both cases, differentiates the transaction from an original issue.

Neither, in the present consideration, is any distinction made between a subscription to stock which is paid in property and a sale of stock with payment in property, the conditions affecting the validity of the stock issue and the character of the stock when issued being the same in either case.

It is to be noted that promoters will frequently turn property in to the corporation at figures in excess of its real cost, the difference representing a secret profit to the promoter. These, and other cases of promoters' secret profits, represent a different phase of the subject and are considered elsewhere. (See Chap. XXXIII, Concerning Promoters.)

§ 206. Present Doctrine.

Unless prohibited by constitutional or legislative enactment, the power of a corporation to issue stock for property is a common-law right that has in many states been reaffirmed by express statutory provision.

In former days such issuance of stock for property and any overvaluation of this latter were nominally concealed and decently habilitated by the passing of cash or checks. The owner of the desired property subscribed for a sufficient amount of stock and paid for it by check or in cash. The check or cash was thereupon, after due authorization on the part of the corporation, returned to the party from whom it was received in payment for his property. The transaction was then complete. The corporation had the property, the former owner the agreed value in stock, while the medium of exchange had returned to the source from which it came.

In the present day this circuitous method is rarely adopted. If the property to be taken over were such as the corporation might legally purchase for cash, it might generally, with equal legality and propriety be taken directly for stock. The following quotations give a fair idea of the present status of the law on this subject:

> "Even where a charter, statute or other governing instrument by its terms requires payment in money,

yet unless the language is such as to import a prohibition of anything but money the courts are generally agreed that payment may be made in any kind of property or services which the corporation may lawfully purchase in the prosecution of its business; provided it be done in good faith and provided such property or services be conveyed or rendered at a fair valuation.

"The reason is that the law does not require the parties to go through the vain transaction which would be exhibited if the subscriber should pay for his shares in cash and if the corporation should hand back the cash in purchase from the subscriber of such property as the corporation might wish to buy from him; or what would be the equivalent of such a transaction, that there should be a mere exchange of checks between the parties." Seymour Thompson in 10 Cyc., 472.

"If the property is taken at a valuation made without fraud, the payment is as effectual and valid as though made in cash to the same amount." 1 Cook on Corporations, § 18.

"Whether stock is issued upon subscription or sold, the corporation, in the absence of express restrictions, may receive, or contract to receive payment therefor in property, labor, or services, provided it would, under the express or implied powers conferred upon it by its charter, have the power to purchase the property or incur a debt for the labor or services, and provided the transaction is in good faith, and no fraud is perpetrated upon other stockholders or creditors." 2 Clark & Marshall, Private Corporations, § 384a.

From this it appears the great essential in the issuance of stock for property is that such property be taken over at a valuation justified by the conditions and that the exchange be made in good faith and without fraud. If so taken over the transaction may be made without the passing of cash and will not in most states of the Union be invalidated for that cause or by reason of subsequent depreciation or even by the fact that the directors erred in their valuation.

In the absence of constitutional or legislative prohibitions, the only ground upon which such a proceeding could be attacked, leaving technical irregularities out of consideration, is the one point as to the good faith and freedom from fraud of the transaction.

If the consideration was adequate, the stock issued therefor is without qualification full-paid and its holders are not liable. If inadequate, or of doubtful adequacy, the full payment of the stock issued therefor is open to question, and if fraud appears, and in some states without fraud, the holders of such stock may be involved in a further liability.

The most liberal presentation of the general doctrine in cases of inadequate payment of stock by property, or what is the same thing, the overvaluation of property received in exchange for stock, is found in 1 Cook on Corporations, § 46, where it is stated:

> "At common law there is no contract, express or implied, to pay to the corporation or to corporate creditors the par value of stock which is issued for property. Not only is there no such contract, but there is no implied fraud even though the property was overvalued. If there is express fraud the law provides ample remedies, but such a fraud must be clearly proven and is not implied from proof that the property was worth less than the par value of the stock.
>
> "This principle of law, that there is no liability on stock issued for property the value of which is less than the par value of the stock, seems a self-evident principle of law. Moreover, this principle is based on business usage and is sound practice. There is no more harm in the issue of stock below par than there is in the issue of a note or bond below par. The extent to which courts have gone in sustaining such issues of stock for property is shown by the fact that even constitutional and statutory prohibitions against watered stock have been practically construed away by the courts. Moreover, the laws of trade are more powerful than the laws of men, and in business circles it has become customary to capitalize property at a

> reasonably high figure. This is due to the fact that it is easier to sell stock at less than par than at par, and also to the fact that by a large capitalization, dividends are kept low enough to avoid the cupidity of possible competitors and the interference of legislatures. To such an extent is this practice carried by issuing stock for property at an overvaluation, that the investing public and persons who give credit to corporations rather expect it, and they no longer rely upon the nominal capitalization of the company. Experience has taught them that they must investigate the real financial condition of the company, and invest or give credit upon that alone."

The acknowledged repute of the text book from which this extract is taken gives weight to what would otherwise seem an extreme statement of the prevailing doctrine. It excuses and justifies the overvaluation of property, and, what is the same in principle, the issuance of stock for less than its par value provided the transaction be characterized by good faith.

From the standpoint of logic and common sense the author's position is undoubtedly correct, but whether it entirely accords with the existing law is not so certain.

As stated, there is no obligation or liability under the common law for the issue of stock for cash at less than par, nor, as a necessary consequence, any liability for the issuance of stock for property no matter what the value of the property, or the valuation placed upon it, or the amount of stock issued therefor. It is merely a matter of contract between the particular parties, and if the corporation does not value its stock at par, or valuing its stock at par, chooses to give more than the value of the property it is taking over, at common law it has the right and does not by the exercise of this right saddle an indefinite possibility of liability upon its stockholders.

But the whole matter of liability on stock issued for property has now become one of constitutional or statutory

creation and differs with the varying provisions of the different states. Therefore no general statement of the doctrine can be made with safety, and in each particular case before issuing stock for property the statutes of the state of incorporation should be examined, and any decision of the state courts in construing these statutes must also be taken into consideration.

The general doctrine, however, as existing in the greater number of states, seems to be that in any case property may be safely taken for stock at a fair valuation, and, beyond this, that so long as the transaction is in good faith and free from fraud, it will not be invalidated because of overvaluation due to mistake or honest error of judgment, or made without intent to defraud.

As will be noted, this allows much latitude in the estimation of values. In most cases, more particularly where speculative values are taken over, there is room for an honest difference of opinion as to the real value, and, as a general rule, the valuations must be obviously excessive, or absolutely fraudulent before the transaction will be disturbed.

This is the position taken by the Supreme Court of the United States in Coit *vs.* Gold Amalgamating Co., 119 U. S., 343 (1886).

> "But where full-paid stock is issued for property received there must be actual fraud in the transaction to enable creditors of the corporation to call the stockholders to account. A gross and obvious overvaluation of property would be strong evidence of fraud."

It must be said, however, that the force of this decision is weakened by the conflicting and harsher opinion of the same court in the later case of Camden *vs.* Stuart, 144 U. S., 104 (1892), as follows:

> "It is the settled doctrine of this court that the trust arising in favor of creditors by subscriptions to the stock of a corporation cannot be defeated by a

simulated payment of such subscription, nor by any device short of an actual payment in good faith. And while any settlement or satisfaction of such subscriptions may be good as between the corporation and the stockholders, it is unavailing against the claims of the creditors. Nothing that was said in the recent cases of Clark *vs.* Bever, 139 U. S., 96; Fogg *vs.* Blair, 139 U. S., 118, or Hanley *vs.* Stutz, 139 U. S., 417, was intended to overrule or qualify in any way the wholesome principle adopted by this court in the earlier cases, especially as applied to the original subscribers to stock."

Certainly under this decision an overvaluation of property even in good faith would not stand as full-payment of the stock taken in exchange therefor.

Also in Scoville *vs.* Thayer, 105 U. S., 143 (1881), the discussion of a contract between a corporation and its stockholders providing that stock received by these latter should be considered full-paid, it is stated:

> " But the doctrine of this court is, that such a contract though binding on the company, is a fraud in law on its creditors, which they could set aside; that when their rights intervene, and to satisfy their claims, the stockholders could be required to pay their stock in full."

In most of the state courts, however, the more liberal doctrine already stated prevails, as set forth in the following decisions:

> "In charging the jury the judge said 'The real question, therefore, is whether the property was placed and taken at a higher valuation with a fraudulent purpose, with the intent of evading the provisions of the statute.' "
>
> " We are of opinion that the court committed no error in the submission of the case to the jury. In Douglass *vs.* Ireland (73 N. Y., 100) it was laid down as the law in this state, that to charge a holder of stock, issued upon and for the purchase of property, individually for the debts of the company, it is not enough to prove that the property has been purchased and

paid for at an overvaluation through a mistake or error of judgment on the part of the trustee, but it must be shown that the purchase at the price agreed upon was in bad faith and to evade the statute." Lake Superior Iron Co. *vs.* Drexel, 90 N. Y., 92 (1882).

"The enquiry, therefore, in the court below, should have been, whether the agreement in question was fraudulent or not; for, if the transaction was an honest one, the difference in value between the property constituting the consideration of the sale and the stock had no legal significance. The charter of this company authorizes the corporation to exchange its capital stock for property, and, under that condition of things, a court of equity cannot set aside a transaction of that kind simply on the ground that the bargain on the side of the corporation is a disadvantageous one. * * * In the absence of deceit, or some other corrupt constituent, the bargain between the parties cannot be disturbed." Bickley *vs.* Schlag, 46 N. J., Eq., 533 (1890).

In both these cases the crucial point was as to whether there was fraud in the valuation of the properties taken over. Gross or obvious overvaluation would be *prima facie* evidence of fraud, but would not be final. If the original parties could show that it was made in good faith and without intent to defraud, in most states the transaction would stand.

If, however, this could not be shown, or if the excessive valuation had been kept secret and debts incurred without those extending credit having full information as to the method by which the stock of the corporation had been full-paid, the transaction would not stand and the stockholders might be forced to pay the difference between the real value of the property and the face value of the stock issued in exchange for such property.

The reluctance of the courts to disturb transactions involving the exchange of stock for property where the valuations are undoubtedly excessive, but made without intent to defraud is strongly shown in the following decision:

> "The parties fixing the valuation were the only parties in interest, and we know of no principle of public policy which condemns an agreement between parties about to form a corporation, because by the arrangement, the capital stock is to be represented by property which they severally contribute, at a valuation agreed upon between themselves. If it had appeared, that the organization of the corporation in this way, was a device to defraud the public by putting valueless stock on the market, having an apparent basis only, a different question would be presented." Lorillard *vs.* Clyde et al., 86 N. Y., 388 (1881). See also Seymour *vs.* S. F. C. Assn., 144 N. Y., 333 (1895).

The foregoing statement of the law applies with much aptness to the issue of stock for property on the organization of the corporation. At this time no creditors exist and the owners of the property and the stockholders of the new corporation are the only parties concerned, and they have the right to put the property into the corporate form at any capitalization they choose. If all are fully aware of the circumstances, if none are making a concealed profit on the transaction and if the purposes of the valuation adopted are free from fraud, such issuance of stock for property is proper and not to be thereafter set aside.

If, however, the organization of the corporation and the valuation placed upon the property taken over are merely part of a scheme to foist doubtful stock upon the public, or to defraud in other ways, then the essential feature of good faith is lacking and the purchasers of such stock as well as subsequent creditors of the corporation may bring those concerned in the fraud to account.

It may be noted, that since the foregoing decisions of the New York and New Jersey courts, the statutes of both states relative to the issuance of property for stock have been changed by the insertion of clauses providing that, "in the absence of actual fraud, the judgment of the directors as to the value of property purchased shall be conclusive." As the

decisions in both states had, prior to these enactments, upheld such transactions when not tainted with fraud, the amended statutes would seem merely to express what was already the law. In both states the absence or presence of fraud has been the deciding point upon which such transactions have been sustained or condemned.

While the general doctrine sustains full-payment of stock by property so long as fraud is absent from the transaction, in some important states of the Union the constitutions or statutes provide expressly that when stock is issued for property, it shall be "to the actual value thereof," or "to the amount of the value thereof." The intention of these provisions is undoubtedly to secure the full and actual payment of stock issued for property and to prevent its nominal full-payment by overvaluation of the properties taken in exchange therefor.

Even in these states the decisions are of varying tenor. In Alabama, where express limitations exist, the following decision clearly recognizes the possibility of an honest variation of judgment as to the value of property. No overvaluation is allowed, but full-payment of stock by means of such property is not questioned so long as honesty and good faith characterize the transaction:

> "The creditors are entitled to demand that the payment on the stock shall be an actual and bona fide discharge of the liability imposed by the contract of subscription. The defendants in making and accepting payment in property, were bound to exercise their judgment and discretion fairly and honestly directed to secure a substantial compliance with the terms of the contract. In the exercise of that judgment and discretion they are entitled to the benefit of whatever margin there may be for honest difference of opinion in the valuation of the property but a deliberate and intentional overvaluation of the property is not permissible." Elyton Land Co. *vs.* Birmingham W. and R. Co., 92 Ala., 407 (1891).

In the following Missouri decisions the law as laid down is enunciated with much harshness. No allowance is made for errors of judgment or other human frailty. Presumably, under this construction, a valuation and transaction of entire legality at the time of the corporate organization might be vitiated by subsequent developments as to the value of the property. Just how this absolute precision of valuation demanded is to be obtained is not indicated by the decisions.

> " Hence the enquiry in a case between the creditor and a stockholder, when property has been paid for in the capital stock of a corporation, is not whether the stockholder believed or had reason to believe, that the property was equal in value to the par value of the capital stock, but whether, in point of fact, it was such equivalent." Van Cleve *vs.* Berkey, 145 Mo., 109 (1898).
>
> " The general rule of law is that it is beyond the power of a corporation to issue its stock at less than its par value, and that where it does so issue its shares, the taker of them is liable in a proceeding by or on behalf of creditors, to make good the difference between their par value and what he actually gives for them. If an exception to this rule is claimed in any particular case, the party claiming the exemption must put his hand upon some statute authorizing the corporation so to deal with its shares." Leucke *vs.* Tredway, 45 Mo. App., 507 (1891). Seymour D. Thompson, Justice.

The general position of this last decision holding that the issuance of stock at less than par is at variation with the principles of the law and impossible unless expressly permitted by statute is in almost diametrical opposition to the doctrine enunciated in the quotation already given from Cook on Corporations, and the two are impossible to reconcile. It must be said, however, that Judge Thompson has always taken an extreme position in regard to the full-payment of stock and has been a vigorous opponent of any mitigation of the rule laid down in his decision. It is not

probable that the rule would now be enforced in any state with the severity indicated. It would, nevertheless, be prudent in the organization of corporations in the states where express limitations exist, to make a careful study of the decisions before risking any excessive valuation of property to be taken over for stock.

§ 207. Cases in Point.

As has been stated, parties interested in a property may organize a corporation, capitalize at any figure they see fit, and exchange the property for the stock of the corporation. As all concerned are fully informed as to the transaction they are within their rights and there is no one in a position to object.[1] So long as the corporation is solvent, litigation can hardly occur. The test of the transaction occurs on the insolvency of the corporation, when creditors not cognizant of the circumstances attending its organization find themselves unable to collect their claims and suit is brought on their behalf. Then the whole matter is gone into and the adequacy of the consideration, the good faith of the transfer and the other conditions of the organization are scrutinized. The following cases are in point:

In Lloyd *vs.* Preston, 146 U. S., 630 (1892), an Ohio corporation had taken over property in payment for its capital stock. All the directors authorizing the transaction were relatives or employees of one of the interested parties, and the property was not worth, according to plaintiff's claim, one-fiftieth of the par value of the stock issued against it. It was held that the overvaluation was so gross and obvious as, in connection with the other facts in the case, clearly to establish fraud and to entitle *bona fide* creditors to enforce payment of their claims against the original subscribers to the stock of the corporation.

In Hebbard *vs.* S. W. Land & Cattle Co., 55 N. J. Eq., 18 (1896), the capital stock of the corporation having been issued for property not worth five per cent. of the par value

[1] The Insurance Press *vs.* Montauk, etc., Co., 103 App. Div., N.Y. (1905).

of the stock, apparently in pursuance of a scheme to secure the issue of the stock full-paid without value having been received therefor, such stock was held not to be full-paid in the hands of those cognizant of, or parties to, the scheme and its execution.

In the case of the National Tube Works *vs.* Gilfillian, 124 N. Y., 302 (1891), the company was organized with a capital stock of $300,000, which was issued for five unpatented inventions. The substantial issue being whether the obvious overvaluation was an error of judgment, or in bad faith, the jury found the stock unpaid and the verdict was upheld.

In Douglass *vs.* Ireland, 73 N. Y., 100 (1878), a company was incorporated with a capital stock of $300,000, all of which was issued in exchange for two contracts, upon which nothing had then been paid, one for the purchase of a mining property and furnace, the other for the purchase of standing timber. The stock was issued to one of the directors, full-paid and non-assessable, and $100,000 par value was turned back to the company to be sold to raise working capital, the balance being divided among the directors. The defendant had purchased a portion of this treasury stock at forty cents on the dollar, and was well aware of the manner in which it had been issued. The jury found that the contracts turned in to the company were worth on a liberal estimate but $65,000. The court held that the transaction was a fraud and that the capital stock of the company had not been full-paid as provided by the New York statutes. The higher court affirmed the judgment.

In Brockway *vs.* Ireland, 61 How. Pr. N. Y., 372 (1880), on the same statement of facts as in the preceding case, another jury, differing absolutely as to the bearing of these facts, sustained the transaction and the stock was held to be full-paid, the two verdicts being in direct contradiction.

In Lake Superior Iron Co. *vs.* Drexel, 90 N. Y., 87 (1882), iron works at Pittsburgh together with certain

patents were turned over to the company in exchange for its entire capitalization of $2,500,000. Of this issue a certain proportion was turned over to a trustee to be sold at the stipulated price of $50 per share, and of the first $100,000 received from this sale of stock, $50,000 was to be paid to the vendors of the property, all other proceeds going to the company. The arrangement was carried into effect. In charging the jury, the lower court said, "The real question, therefore, is whether the property was placed and taken at a higher valuation with a fraudulent purpose." The jury decided that the transaction was in good faith and the higher court refused to disturb the verdict.

§ 208. Resumé of Doctrine.

From the foregoing general consideration of the subject the following deductions may be made:

In the absence of constitutional, statutory or charter provisions affecting the issuance of stock for property, the common law prevails, and under it stock may be issued for property at the discretion of the corporation and without danger of subsequent liability on the stock so issued. In case of fraud, the perpetrators would be liable on that ground but the issued stock would not be held unpaid.

Where legislative or other prohibitions exist against the issuance of stock except for cash, stock may nevertheless be issued for property that is fairly of the face value of the stock given therefor and there can be no subsequent liability on stock so issued.

In a few states, valuation of the property received in exchange for stock must be made with much precision, and any error of judgment—which might be shown only by subsequent developments—may bring about a liability on the stock so issued equal to the difference between the actual values received for such stock and its face value.

These stringent provisions are found in but a few states. Elsewhere the law and the construction of the law are as

a rule liberal, and any honest error of judgment as to the value of property taken in exchange for stock, even though it brings about an excessive valuation of the property, will not entail a liability therefor upon the holders of the stock. Also a " reasonable margin for honest difference of opinion " is allowed, and a moderate overvaluation is not likely to be disturbed if made without intent to defraud.

Any obvious and excessive overvaluation will, however, in any of the states be held as *prima facie* evidence of fraud, and the burden of proof will be thrown upon the stockholders to show that fraud does not exist. If they fail in this the stock will be held but partly paid and the original stockholders, knowing the circumstances attendant upon the issue of their stock, will be held liable for its full value.

In all the states, any overvaluation of property taken in exchange for stock with the knowledge and consent of all the parties thereto will be upheld as between these parties and as between the corporation and its stockholders.

In most of the states overvaluation made with the consent of all parties interested will not only stand as between them, but as to subsequent creditors if these latter extend credit with a full knowledge of the method by which the stock was full-paid.

Any definite " danger line " in the valuation or overvaluation of properties taken in exchange for stock is impossible to fix. Even the very liberal views expressed in Cook on Corporations on this subject are qualified as follows:

> " There is a limit beyond which the courts will not go in sustaining the issue of stock for property taken at an overvaluation. If the property which is turned in is practically worthless, or is unsubstantial and shadowy in its nature, the courts will hold that there has been no payment at all, and that the stockholders are liable on the stock." 1 Cook on Corporations, § 46.

This is probably a correct statement of the situation in the more liberal states. Property less than 6 per cent. of the value of the stock issued for it, and property not worth one-fifth of the stock issued therefor were, in the decisions already quoted, held as payments in fraud and set aside. Where there is, however, a really substantial value to give a basis for the transaction and to differentiate the enterprise from the " unsubstantial and shadowy," the courts are slow to disturb the arrangement and will not do so if it can reasonably be avoided.

It should be noted that this liability on stock nominally full-paid but so characterized improperly extends only to the original and such subsequent stockholders as are cognizant of the transaction. Innocent purchasers of stock for value, buying it as full-paid and knowing nothing of the proceedings by which their stock was supposedly full-paid, could not be held, no matter what the price paid by them for their stock. (1 Cook on Corporations, § 50, and cases there cited.)

§ 209. Property that may be Received.

The corporation has the same liberty as to the character of property taken for stock as it has in the purchase of property for cash. It is essential that the property be such as the corporation under its charter has power to take. If the property is not necessary to the conduct of its authorized business, any contract for its purchase, either for stock or cash, is, unless expressly permitted by its charter, *ultra vires,* and stock issued therefor would not be paid-up stock. (Powell *vs.* Murray, 3 App. Div. N. Y., 273; aff'd 157 N. Y., 717, 1899; Montgomery *vs.* Brush El. L. Co., 48 App. Div., N. Y., 12; aff'd 168 N. Y., 657, 1901.) The importance of this principle is, however, much diminished by the modern practice of redundant charters which permit the acquisition, either directly or by obvious implication, of every kind of existing property which a corporation may hold.

The property taken in exchange for stock is usually an existing business, a mining property, patented invention, real estate, lease, copyright, trade-mark, license to use patents or something of similar nature. There is no doubt but that these, the ordinary properties of commerce, may be taken.

A railroad may issue its stock and bonds for construction, material and right of way, and any corporation may issue stock for labor done or services performed in pursuance of a valid contract.

A corporation may issue its stock in payment for the stock of other corporations in all those states where it may hold the stock of other corporations of similar or collateral purposes. It may also issue its stock for contracts if such contracts have a substantial value.

Stock may be issued for options if these latter are really of value. A single option, for which and upon which nothing had been paid, would hardly be a sufficient consideration for an issue of stock. It would not seem reasonable, however, to hold this view in connection with an option such as that for which Carnegie received $1,000,000 in the negotiations prior to the formation of the Steel Trust. Also a number of related options, whereby a valuable consolidation could be effected, would seem to be a property of value and a sufficient consideration for a reasonable stock issue. The validity of stock issues against property of this kind has not, however, been fully adjudicated, and in case of insolvency it is probable that the valuations usually placed upon options and contracts exchanged for stock would be held excessive.

Stock may be issued in payment for good-will where this latter really exists. (Washburn *vs.* National Wall Paper Co., 81 Fed. Rep., 17, 1897.) In the case of Camden *vs.* Stuart, 144 U. S., 104 (1892), the court rejected the claim for the " experience and good-will " of the partners, but the rejection was based upon the facts of the particular case

and was not expected or intended to establish any general doctrine. Not infrequently good-will is one of the most valuable single assets of a going concern and would with entire propriety and legality be recognized to the full in any issue of stock in payment for the business.

§ 210. Usual Procedure.

The usual procedure in the organization of the large modern industrial corporations or trusts, which are formed for the purpose of taking over property against the issue of all, or a large portion of their stock, is to utilize so-called "dummies" for both incorporators and the first directors. These are usually young men connected with or furnished by the parties having charge of the incorporation. The only requisites are that they be of age, capable of contracting, and one or more, as may be requisite, citizens of the state in which incorporation is had. These "dummy" incorporators pay the necessary fees, take out the certificate of incorporation, and comply literally and exactly with the statutes of the state of incorporation.

After allowance of the charter these incorporators meet, adopt by-laws, and, if the directors are not named in the charter, elect a board of directors. The owners of the properties to be taken over, or the parties controlling them, then present a formal proposition to exchange their properties for a portion or the whole of the capital stock of the new corporation. This is not accepted by the stockholders of the new corporation, but is formally approved by them and referred to the board of directors with a resolution instructing its acceptance. The work of the dummy incorporators is then complete unless, as is usually the case, these incorporators are likewise to act as directors.

Usually the directors of the new corporation are named or chosen from among the incorporators, are of the same somewhat inadequate financial responsibility, and are of like temporary tenure. They usually meet immediately after

the adjournment of the first stockholders' meeting, elect officers (who are usually likewise temporary) and then take up the proposition for the exchange of stock for property together with the stockholders' resolution directing its acceptance. The proposition is accepted by resolution, and the proper officers of the corporation are authorized and instructed to receive the property and to issue the requisite stock therefor, full-paid and non-assessable, to the order of the vendors.

The shares subscribed for by the incorporators are usually included in the stock paid for by the accepted properties, and are generally retained by the dummy directors until such time as their work is completed. Sometimes the dummy incorporators and directors are allowed to keep the one or more shares respectively subscribed, as their profit on the transaction. More frequently this stock, or the subscription therefor, is assigned over to the vendors and an honorarium of from $5 to $20 paid each of the incorporators, though at times they do not receive even this modest recognition of their services.

After the completion of the formalities laid out for them by the counsel in charge of the incorporation, the original directors, one by one, resign, their places are filled seriatim as dictated by the parties behind them, and the real parties in interest come into nominal as well as actual control.

The officers of the dummy board are sometimes retained to carry out the formal details of the issuance of stock and the receipt of the property, but usually resign and allow the permanent officers of the company to complete the details of the transfer.

This method of organization by means of "dummies" has been much criticized, but is entirely legal, is usually under the direct control and direction of skilful counsel, and is made to conform to the exact letter of the law. In Dickerman *vs.* Northern Trust Company, 176 U. S., 181 (1900), a case in which the transaction was so grossly fraud-

ulent that the court would have seized any opening to condemn the promoters, Justice Brown reluctantly admitted that there was no legal flaw in the organization by means of dummy incorporators and directors. He said:

> "While the first board of directors seem to have been mere tools in the hands of the New York firm with no real interest in the company, they appear to have conformed to the letter of the law, and until formally dissolved the corporation had a legal existence."

If the new organization is successful, the method of organization is never questioned. If the property is not overvalued, the matter would have no bearing even though the company went into insolvency. If, however, the property is so obviously overvalued—as is often the case in the large organizations—that fraud is at least implied, those attacking the matter add rhetorical effect by vigorous denunciations of the dummy incorporators and directors.

As a matter of fact, the real status of the matter is not effected by the employment of a temporary organization and dummy agents. Everything has been decided upon—intelligently, whether properly or otherwise—before these dummies are brought into the plan, and they are merely employed as a convenient means to a clearly designed and pre-arranged end. The principals may escape some undesired publicity as well as much inconvenience and loss of time by the employment of these agents, but they do not escape responsibility, and, in case of any wrong doing in these preliminary operations, would be as liable as if they had acted directly. The whole matter is purely one of form, and merits but little of the attention and indignation it occasionally receives. (See § 87.)

Promoters' frauds are usually worked in the organization of a corporation through the means of dummy incorporators and directors. Illogically both the corporate system and the use of dummy representatives are denounced for these frauds instead of the men who use legitimate

agencies for ill ends. (See Hutchinson *vs.* Simpson, 92 App. Div. N. Y., 382 (1904); also case of Dickerman *vs.* Northern Trust Co., 176 U. S., 181 (1900), above cited.) (See Chap. XXXIII, Concerning Promoters.)

§ 211. Donation of Stock to Treasury.

In the organization of a corporation to take over property, it is customary to return to the company for treasury purposes a portion of the stock issued for the property. Having been full-paid by the issue for property it may be sold at less than par, or be given as a bonus with preferred stock or bonds without involving the holders in liability. (See Chap. X, Treasury Stock.)

Such return of stock to the treasury is legitimate. In a few cases, the courts have instanced the fact that this has been done as an evidence that the property received for such stock was overvalued. This is obviously not a correct construction as, if the stock were properly issued in the first place, it becomes the actual property of the holders, and if they see fit to devote a portion of it to the general interest and upbuilding of the business, the matter is within their power and entirely legitimate. (See 1 Cook on Corporations § 46; also 2 Clark & Marshall, Private Corporations, §390e; The Insurance Press *vs.* Montauk, etc. Co., 103 App. Div., N. Y., 1905.)

CHAPTER XXXIII.

CONCERNING PROMOTERS.

§ 212. The Promoter's Function.

A promoter is one who actively engages in the financing and organization of an enterprise under the corporate form. The term is described by an English authority as a "short and convenient way for designating those who set in action the machinery by which the Act enables them to create a corporation." Cook briefly classifies the promoter as a "person who brings about the incorporation and organization of a corporation."

Another idea enters into the modern everyday business use of the term. The promoter's activity and interest in the affairs of the enterprise are incited by the expectation of special profits. If he does not realize or expect to realize special profits out of the undertaking he is not, in modern parlance, a promoter, though filling every requirement of the legal definition.

In the organization of most modern corporations the promoter plays an active and very important part. His anticipated special profits from these efforts are usually large and not infrequently excessive. His arrangements whereby these special profits are to be secured have given rise to a class of cases turning solely upon the relations existing between the promoter, his associates and the corporation. The ideal of the law in regard to these relations is high. It is to be regretted that the methods of promoters are usually on a much lower level.

§ 213. Promoter's Relation to Corporation.

For the purposes of the present consideration the promoter is one who concerns himself in the financing and organization of a corporation with a view of realizing special profits. In a large proportion, if not the majority of such cases, the promoter has brought about the organization of the corporation for the express purpose of securing these special profits. There is no intrinsic iniquity or injustice in so doing. The only question is as to the propriety and legality of his arrangements for their collection. Too frequently the methods of the promoter are not only of doubtful moral status, but directly in conflict with the established law.

The relation of the promoter both to the corporation and to those associated with him in its organization is one of trust. He is guiding the affairs of the incipient corporation and is supposed to be safeguarding its interests as he would his own.

> "Their relation to the persons who become corporators or subscribers to stock, and their relation to the proposed corporation, when formed, is a fiduciary relation, or a relation of trust and confidence." 1 Clark & Marshall, Private Corporations, § 110b.

This doctrine is too clearly established to be questioned. The confidential relations of the promoter being admitted, it follows then, that while he may with entire propriety and legality profit by his connection with the corporation, such profit must be made and taken in such ways as are compatible with these existing confidential relations.

§ 214. Illegal Arrangements.

The usual mistake of the promoter is in dealing with the corporation as he would with a stranger. Unreasonable or even large profits are difficult of attainment if the party from whom they are to be drawn is informed as to the facts, and for this reason the promoter wishing to sell property to the corporation usually conceals, or worse still, misrepresents its real cost. If the property were actually owned by the promoter

and had been so owned before the organization of the corporation was undertaken, the status would be different. Then, under proper conditions, there would be no compulsion upon him to reveal the cost of the property and he might sell it to the corporation at any agreed price, and, in the absence of misrepresentation, without fear of legal consequences.

Usually, however, the promoter does not own the property taken over by the corporation, but either holds it under option or is acting in the interests of the real owner, who pays him a percentage of the price secured, or allows him to offer it to the corporation at an advanced price, protecting the promoter in all excess over the real price to the owner. When the promoter occupies this position, unless with the full knowledge of his associates and the corporation, he is in conflict with the law, for it has been laid down clearly and unmistakably that a promoter must not make any secret profit out of his corporation, or out of those associated with himself in the formation of the corporation. As stated by Clark and Marshall, in conclusion of the quotation of the preceding section:

> "And for this reason it is well settled that they will not be permitted to take advantage of their position in order to make a secret profit out of their transactions on behalf of the proposed corporation or of the corporators or out of their dealings with the corporation or corporators."

The leading case on this subject is that of Erlanger *vs.* New Sombrero Phosphate Co., 5 Ch. Div., 73; aff'd in 3 App. Cases, 1216 (1878). This is an English case, but its doctrines have been generally followed in this country. Erlanger and his associates formed a syndicate to purchase a phosphate island which was offered to them for £55,000. Through agents a company was then formed, Erlanger naming the five directors. Of these two were at the time out of the country. Of the three remaining one was Erlanger's private agent, one was Lord Mayor of London and the third was a Rear Admiral

of the British Navy. These two latter were not interested in any way with Erlanger in the sale of the island to the corporation, were not informed as to the circumstances and did not make any inquiry, but, acting with the Erlanger director, accepted Erlanger's proposition to sell the island to the corporation for £80,000 in cash and £30,000 in shares. Stock in the corporation was then sold until some 400 shareholders were interested in the company. Later these secured control of the company, and promptly brought suit against all parties concerned in the sale of the island to the company. As a result the sale was ordered rescinded and the vendors were ordered to return the price of the island to the company, upon which the island was to be restored. This decision was affirmed upon appeal. The Lord Chancellor, in rendering the decision, said:

> "I do not say that the owner of property might not promote and form a joint stock company and then sell his property to it, but I do say that if he does he is bound to take care that he sells it through the medium of a board of directors who can and do exercise an independent and intelligent judgment on the transaction, and who are not left under the belief that the property belongs not to the promoters, but to some other person."

The doctrine of the case was, first, that independent directors should have been named; and second, that the promoters should have made full disclosure to these directors of all material facts. In the decision it was intimated that if one director personally beyond suspicion had known the real facts as to the increased price, it might have been sufficient to validate the sale.

The doctrine in this country seems to be similar. When property is taken by promoters for the purpose of sale to the corporation, whether by purchase, option or agreement, they are bound to disclose any private bargain or secret profits. The relations are confidential and each person is bound, as in partnership, to act with entire openness and

fairness to those with whom he is associated. The law as to this is very clear and has been passed upon again and again. As stated in Densmore *vs.* Densmore, 54 Pa. St., 43 (1870):

> "Where persons form such an association or begin or start the project of one, from that time they do stand in a confidential relation to each other and to all others who may subsequently become members or subscribers and it is not competent for any of them to purchase property for the purpose of such company and then sell it at an advance without a full disclosure of the facts."

From the cases cited and the additional cases given hereafter, it is clear that any special profits made by the promoter are illegal unless made with the full knowledge of all the others interested or with the consent of an independent and fully informed board of directors, or with disclosure of the conditions to intending stockholders. Suit for redress might be brought at any subsequent time by the corporation, or, under some circumstances, by the stockholders who have immediately contributed to the promoter's improper profits by the purchase of stock on its first issue, or of treasury stock thereafter.

It is to be noted that purchasers of stock from others than the corporation do not have a right to any such redress. As stated in Walker *vs.* Anglo-Am. M. & T. Co., 72 Hun, 341 (1893):

> "A purchaser of shares in an existing corporation from a stockholder, has no interest in the application of the money which he pays for the shares, but it is quite different with one who agrees to subscribe for shares in a corporation to be created." Also see Twycross *vs.* Grant, 2 C. P. Div., 483.

These cases where suit is brought for the restoration of promoters' profits must not be confused with that other class in which recovery is had by *creditors* because of the overvaluation of property turned into the corporation in ex-

change for stock, or bonds, or both. The two cases often go together, but are radically different in their nature. An improper profit to promoters might exist without any overvaluation and an overvaluation might exist without any improper profits to the promoter. For instance, property at an overvaluation might be accepted by the corporation and its stockholders with a full knowledge of the promoters' profits. They would then have no basis for proceedings against the promoter. A creditor might, however, in such case proceed against the stockholders on the ground of an overvaluation. On the other hand, the property might be put into the corporation at a fair figure, but the promoters receive a secret commission, or rebate or other improper profit on the sale. No suit for overvaluation would then hold, though there would be good grounds for proceeding against the promoter for the recovery of the improperly-gotten profits.

For further decisions affecting improper arrangements of promoters, see: Getty *vs.* Devlin, 54 N. Y., 403; S. C. 70 N. Y., 504 (1877); Brewster *vs.* Hatch, 122 N. Y., 349 (1890); Woodbury Heights Land Co. *vs.* Loudenslager, 55 N. J. Eq., 78 (1896); Ex-Mission Land and Water Co. *vs.* Flash, 97 Cal., 610 (1893); Plaquemines Tropical Fruit Co. *vs.* Buck, 52 N. J., 219 (1893); and Densmore Oil Co. *vs.* Densmore, 64 Pa. St., 43 (1870).

§ 215. Legitimate Arrangements.

The laws are very clear in their denunciation of the promoter's secret profits. They are hardly less explicit in their recognition of the promoter's right to profits if secured and taken under proper conditions. In 1 Morawetz on Private Corporations, § 293, it is said:

> "However, there is no rule of law prohibiting a person from forming a corporation for the purpose of selling property to it and making a profit from the sale. The law merely requires that such a transaction

be entirely open and free from deception upon the company and upon those who become members."

Also in Densmore *vs.* Densmore, 64 Pa. St., 43 (1870), already quoted from, the court said:

> "Any men or number of men, who are owners of any kind of property, real or personal, may form a partnership or association with others and sell that property to the association at any price which may be agreed upon between them, no matter what it originally cost, provided there be no fraudulent misrepresentations made by the vendors to their associates. They are not bound to disclose the profit which they may realize by the transaction. They were in no sense agents or trustees in the original purchase, and it follows that there is no confidential relation between the parties which affects them with any trust. It is like any other case of vendor and vendee."

Also in Plaquemines Tropical Fruit Co. *vs.* Buck, 52 N. J. Eq., 219 (1893), following the case of Erlanger *vs.* N. S. P. Co., already quoted from, the court said:

> "Buck as the promoter of the corporation stood in a fiduciary relation to the company as soon as it was organized. As said promoter it was open to him to sell property which he owned to the company on making full and fair disclosure of his interest and position with respect to this property. Not only was such disclosure necessary, but it was incumbent on him, as sole promoter of the company formed to purchase this special property, controlling and moulding its organization, to furnish it with an executive or board of directors capable of forming a competent and impartial judgment as to the wisdom of the purchase at the price which was paid."

From these quotations it seems very clear that the promoter is well within his rights when he organizes a corporation to purchase his own property, provided that such purchase by the corporation is directed by an independent board capable of impartial judgment as to the value of the

property and the advisability of the purchase by the corporation, and is made with full knowledge of the fact that the property in question belongs to the promoter. In such cases the promoter having purchased or otherwise acquired such property before the inception of the corporation, was not and could not then in any way have been acting as the agent or trustee of the corporation. He may have acquired such property at any price or in any way, and, when later the corporation is organized, he is at liberty to offer this property to the corporation at any advanced, or different price he may choose, without divulging the profits to be made thereby. The one essential is that such offering shall be absolutely without misrepresentation. If he represents that the property is owned by him when only held by option, or that it is turned in to the corporation at the cost to him when he is really making a profit, such misrepresentations are, under the circumstances, material and render the promoter liable for the secret profits so secured. Without such misrepresentation, however, he may make what profit he will.

The courts go even further than this, as in the later English case of Lagunas Nitrate Co. *vs.* Lagunas Nitrate Syndicate, 2 Ch., 392 (1899), where the ground was taken that when a full disclosure was made to the parties who were later induced to join the company, the independent and competent board of directors could properly be dispensed with.

Also in re Ambrose Lake Tin & Copper Mining Co., 14 Ch. Div., 390 (1880), where a mine valued at £6,000 was assigned to a company by its promoters for £24,000 of its stock. Later the official liquidator brought suit against the promoter for the difference between the real value of the mine and the nominal value of the stock received by the promoters, but, no stock having been sold to outsiders and the transaction being altogether between the parties concerned and there having been no concealment, no one was wronged and the Court refused to hold the promoters. This

decision was sustained on appeal. No rights of unpaid creditors came into this case.

In this country the position of the courts is the same. In Parsons *vs.* Hayes, 14 Abb. N. C., N. Y., 419 (1883), property was turned in at a gross overvaluation, but the only persons in interest were informed of all details and did not object, therefore the promoters were held to be within their rights and the contract not subject to rescission. This case is discussed in 1 Morawetz on Private Corporations, § 290.

Also in Tompkins *vs.* Sperry, Jones & Co., 96 Md., 580 (1903), a receiver attempted to hold the promoters responsible under the same circumstances but his application was denied on the ground that there was no concealment and therefore no wrong. The New York case of Seymour *vs.* Spring Forest Cemetery Assn., 144 N. Y., 333 (1895), is to the same effect.

From this would appear that if with the full knowledge of all concerned as to the circumstances thereof, a corporation is organized and property is exchanged for a portion or the whole of its stock, the completed transaction has harmed no one, is absolutely legal and is not open to later objection by any of the parties consenting thereto. The promoters may make such profits as they please and the other participating parties consent to, and up this point the transaction is legitimate and unobjectionable. (The Insurance Press *vs.* Montauk, etc. Co., 103 App. Div., N. Y., 1905.)

Nor, if the price paid for the property taken was within reason, or capable of justification, is there danger of any subsequent objection, no matter what profit may have been made by the promoters. Nor, even if the price and profits were entirely out of reason and totally unjustifiable, is there any danger of adverse legal action if creditors and subsequent stockholders are informed as to the conditions before they give credit to the corporation or invest in its securities. If, however, under such conditions, stock is sold or obliga-

tions contracted by the corporation without proper publicity as to the basis of credit or stock value, a cause of action may accrue either against those who originally transferred the overvalued property to the corporation, or against the holders of the stock which, as shown by results, was not full-paid. This would, however, be a matter only of overvaluation, the profits received by promoters being merely an incident and not the point at issue. (Salomon *vs.* Salomon & Co., App. Cases, 22, 1897.)

A recent and typical case of interest in this connection is that of Hutchinson *vs.* Simpson, 92 App. Div., N. Y., 382 (1904). An interesting discussion of this case and of the questions involved is given in the dissenting opinion by Judge Hatch.

§ 216. Incidental Liabilities.

The relations between associated promoters will be determined by their agreements. In the absence of any agreement to the contrary, one promoter may require contributions from his associates for any expenses or outlay incurred in connection with their undertaking.

Promoters receiving subscriptions for the stock of a corporation to be organized by them are responsible to the subscribers for the amounts received if they fail to complete the organization.

If promoters perform services and incur expenses in procuring subscriptions, or in doing things for the benefit of the prospective corporation, the corporation when organized cannot be held responsible for such expenses and services unless it expressly undertakes to assume them. If it does assume them, the benefits received by the corporation from such acts and expenditures will be deemed sufficient consideration to support such assumption.

Contracts and agreements made for a corporation before its organization by a promoter do not bind it, unless the corporation accepts the same, either by express action, or

impliedly, by taking the benefit of such contracts and agreements.

A promoter entering into a contract on behalf of a corporation to be formed, will be himself liable on such contract unless it is expressly understood that the other party is to look to the corporation alone.

An agreement by a promoter with the vendor of property to the promoter's corporation, for a private commission, or the excess obtained over a specified price, such payment or profit being unknown to the corporation, is contrary to public policy and illegal and the promoter could not maintain an action to recover. (See § 16.)

§ 217. Restrictions on Sale of Stock.

It is often desirable to restrict the sale of outstanding stock for a limited period, in order to permit the prior sale of treasury stock or to obtain other ends. This may be effected to a certain extent by placing such stock in a voting trust for a specified period. In this case, however, the trustees' certificates might be sold and interfere with the purposes of the restrictions. (See § 226.)

In New York it has been decided that promoters, by agreement, may deposit their certificates of stock with a trust company, not to be withdrawn therefrom or sold for a specified period unless by mutual consent. (See Williams *vs.* Montgomery, 148 N. Y., 519, 1896.)

It has also been decided in New York that stockholders may associate themselves and have their stock issued to them jointly, with an agreement that such certificates shall not be changed, sold or pledged for ten years, except upon consent of all interested. (See Hey *vs.* Dolphin, 92 Hun, N. Y., 230, 1895.) In this case the contract was practically one of partnership in the stock for the designated period. A power of attorney given one of the partners to vote upon this stock was held to be irrevocable.

All parties consenting, it would probably be practicable to make a valid agreement, to which the corporation would be a party, providing that certificates for certain stock should not be issued to those entitled to them, unless by mutual agreement, until a certain specified time, or until a stated proportion of treasury stock had been sold.

Generally, however, courts do not favor agreements suspending or restricting the right of alienation of stock, such agreements being usually held contrary to public policy and void.

PART VI.—SUNDRY CONSIDERATIONS.

CHAPTER XXXIV.

UNDERWRITING.

§ 218. General.

When any very large or important enterprise is to be incorporated and financed, it is customary to underwrite the corporate securities before they are offered at public sale. This practice has been particularly characteristic of the organization of the many industrial combinations formed in the last decade, their securities, almost without exception, having been underwritten before the date of issue.

Underwriting is a guarantee of the sale of the underwritten securities at a specified minimum price. It is, in fact, a conditional subscription for such securities, the underwriters obligating themselves to purchase at a specified price all of the underwritten securities not sold at an advanced price at public offering or otherwise, on or before a fixed date, or within a certain time of the underwriting.

The inducement offered the underwriters for the responsibility they assume is usually a certain portion, or even the whole of the advanced price at which it is expected the securities will be sold to the public. That is, if the price to the underwriters on an issue of bonds is 95 per cent. such bonds might be offered to the public at 98 per cent. or at par. If offered at par, the underwriters' agreement might call for half this excess over the underwritten price, that is, 2½ per cent. of the total amount received on such sales. If all the bonds were sold, the underwriters would then receive $25.00 for each $1,000 bonds of the issue, this amount

being pro rated among the underwriters in accordance with their subscriptions. If but a part of the issue were sold, the underwriters would receive $25.00 on each bond sold, but would themselves have to purchase the unsold bonds at the underwriters' price of $950 for each $1,000 bond. A stock bonus is frequently given the underwriters in addition to the contemplated cash profits or in place thereof.

It is obvious that the underwriters, if their obligations are to be of any effect, must be men of considerable financial responsibility. It is expected that the securities underwritten will be sold, but the underwriters must always be prepared in case of failure to take up the unsold securities themselves. They would therefore hardly underwrite securities of doubtful value, and as the underwriting price is supposed to be a little below the real worth, the possibility of having to purchase such securities is not—if the underwriters are financially strong—disquieting. If compelled to purchase, their money would be invested in the securities, but these presumably would be desirable, and the price at which they were purchased below what might reasonably be estimated as their value.

If the public offering or other sale of the underwritten securities is successful, the underwriters profit largely without the investment of a dollar. That is they are handsomely paid for their guarantee, without having been called upon to do more than to be ready to follow it up if the necessity had arisen. The operation is a legitimate one, and at times very advantageous both to the underwriters and the corporation to which the underwritten securities belong.

During the flush times, but lately passed, when the investing public was anxious to share in the profits of monopoly and flocked with enthusiasm to purchase the highly watered stocks of the various industrial combinations, the underwriters reaped a golden harvest. During this period the underwriting responsibilities were nominal. The public absorbed everything offered by the magnates of the

financial world, the underwriters' profits were taken without risk or responsibility beyond that involved in the temporary use of their names and the profits were extraordinarily large. This period culminated with the flotation of the Steel Trust, in which the underwriters' profits were enormous.

After the financing of the Steel Trust the underwriters of the succeeding period fell upon evil days. The almost invariable success of the larger underwritings had rendered usually conservative financiers reckless. They underwrote beyond their real financial ability or in excess of prudence, and without proper investigation of the underwritten enterprises, and when buyers did not respond to the public offerings and the underwriters were called upon to "make good" the results were disastrous.

It is obvious that the underwriting of any enterprise not absolutely safe and well conceived is beyond the realm of sound finance. Reckless underwriting as that of the Shipbuilding Trust is merely gambling on a princely scale.

§ 219. Method.

Common stock, preferred stock or bonds may be underwritten, though usually only the latter two are utilized for the purpose.

The underwriting agreement is in form a subscription to the stocks or bonds involved, the body of the agreement stating in detail the terms and conditions under which the subscriptions are made. The amount of securities to be offered, the price to the underwriters—or members of the syndicate when the underwriting is taken by a syndicate—the date, price or terms of the public offering, the profits to the underwriters and the terms of the underwriting subscriptions are all important features of the agreement. It is usually provided that the instrument shall not be effective until a fixed sum has been underwritten.

If certain amounts of cash are needed before the cor-

poration is in shape to offer its securities at public sale, for purchase of plants or preliminary expenses or other purposes directly pertaining and necessary to the matter in hand, the underwriting agreement may provide for advances or payments on account by the underwriters, such amounts to be repaid from the moneys received from public subscriptions. Or, if it is not desired to call upon the underwriters directly, such preliminary amounts are secured on the credit of the underwriting from trust companies or other financial institutions. If the underwriters are of sufficient financial strength to make their underwriting effective, their subscriptions, in connection with the obligations and securities of the corporation itself, furnish ample security for reasonable advances.

The underwriters' respective subscriptions mark the limit of their liabilities and responsibilities, and, in event of profits ensuing, determine the proportion of profits each is to receive. These respective subscriptions will specify so many shares of stock or such a number of bonds. If the public offering or other sale should be a total failure, the underwriters will be called upon to take the full amount of stocks or bonds called for by their subscriptions. If but a portion of the proffered securities are purchased by the public, the underwriters receive their respective proportions of the profits on the securities actually sold, and the balance of the underwritten securities are pro-rated among them in due proportion.

It is usual in underwriting agreements to provide that the underwriters shall have the privilege at any time before the public offering, or up to some specified time before the public offering, of purchasing the securities underwritten by them—in whole or in part—at the specified underwriting price. When the underwriting is a sound one this privilege is frequently exercised. This proceeding terminates the connection of the individual underwriter with the agreement to the extent of his purchase.

The underwritten securities are usually offered to the public through some trust company, or other financial institution which has been designated by the underwriting agreement to act as trustee. Or when the underwriting is done by a syndicate, this syndicate may make the public offering directly or through its own channels. If offered through a trust company, such company will apportion the proceeds in accordance with the terms of the agreement. If offered by a syndicate, the apportioning would be done within the syndicate, the corporation merely holding the syndicate for the net price to be received by it for its securities. In this latter case the underwriting agreement would probably only call for a certain net price on the securities involved, the syndicate being left free to offer the securities at such price —possibly within specified limits—as they may deem advisable, the syndicate bearing all expenses of the sale and retaining as their profits all excess secured by them over the net underwriting price. (See Forms 11 and 12.)

§ 220. Advantages.

The advantages of a substantial underwriting are in most cases very material. The success of the flotation is secured from the moment that the underwriting is completed, and the immediate managers of the undertaking are relieved from the necessity of giving their attention to this important matter. Also, if funds are needed for preliminary operations, underwriting advances may usually be made a part of the contract, or if this is not desired, money may be easily raised on the credit of the underwriting. The underwriting is a guarantee by responsible people that the necessary money for the securities for the corporation will be forthcoming at the time fixed by the agreement, and such a guarantee under proper conditions may easily be turned into cash.

In addition to this, the mere fact that men of the repute and financial strength necessary for effectual underwriting

are behind the enterprise, or are willing to stand for it even temporarily, is in itself a very strong endorsement of the undertaking, giving it weight and position, and materially assisting in the public sale of its securities.

Underwriting is not ordinarily employed when an issue of securities is to be floated by a corporation so strong, or an undertaking so excellent and well known as to command public confidence and money on its merits. Its proper field is found in those cases where the enterprise is new, or in a new form, or is not properly understood, or the conditions are so unfavorable that no matter what the real merits of the offering may be there is danger of an inadequate response to the public offering. Under these circumstances, the financiers, well knowing the real strength of the offering. or confident of their own ability to place it, may be perfectly willing to assume the responsibility of such an underwriting, and thereby insure the success of the issue.

Under any such conditions the corporation can very well afford the liberal payment usually accorded underwriters, and financiers fairly earn their profits, even if they are called upon to do nothing more than loan the use of their names. Even so strong and well-known a corporation as the Pennsylvania Railroad resorted to underwriting in a recent issue of its stock, and, though the underwriting profits ran into the hundreds of thousands of dollars, the Company's course was not criticized by sound financiers. The times were unfavorable, the success of the issue was not absolutely assured and its failure, even though partial, would have been disastrous, involving loss of prestige, as well as failure of the anticipated funds. The price paid to avoid these possibilities—if not probabilities—was a well justified employment of the company's funds.

CHAPTER XXXV.

VOTING TRUSTS.

§ 221. General.

It is frequently necessary or important that the agreed management of a corporation be preserved consecutively for a term of years. This may be for the protection of minority or special interests, or to maintain a control satisfactory to the majority as then existing, or in pursuance of organization agreements, or in accordance with the terms of a re-organization or consolidation. In any case the voting trust is the usual means by which this is secured. It is also called a "stock pool."

The voting trust is an arrangement under which sufficient stock to insure the desired ends is placed in the hands of trustees for some certain period of time with definite instructions as to the way in which this stock shall be voted. Other features may enter in, as the prevention of the alienation of the stock held by these trustees, special dispositions of the dividends thereon, etc., but the designated exercise of the voting power of the trusteed stock for the given period is the main end sought in the formation of the voting trust. (See Knickerbocker Inv. Co. *vs.* Voorhees, 100 App. Div., N. Y., 414, 1905.) (See §§ 233, 240 and 252.)

It is to be noted that the objects to be attained by the voting trust can often be secured more permanently by the formation of a "holding corporation." (See Chap. XXXIX, Holding Corporations.)

§ 222. Distinctions.

The voting trust as here considered applies only to the stock of a single corporation and must be distinguished

from the voting trust arrangement under which attempts were formerly made to combine a number of corporations under one management. That system was legally unsound and has been abandoned. (See Chap. XL.) Neither has a voting trust any necessary connection with restrictions on the sale of stock. Provisions restricting the sale of stock for a specified period or to anyone not embraced in the agreement may be included but are merely incidental to the voting restrictions which are the main end of the trust.

§ 223. How Formed.

A voting trust is formed by placing in the hands of trustees such proportion of the stock of the particular corporation as may be necessary to secure the desired control. These trustees act under and their powers are defined by an agreement, styled the voting trust agreement, subscribed to by all the parties entering the trust. This agreement specifies the length of time for which the stock is to be held and the manner in which it is to be voted at the annual election of directors. If the management then in power is to be retained, the trustees would be instructed to cast the vote of the trusteed stock in all elections of directors for the parties then constituting the board, suitable provision being made in case of the possible death of any of the parties named. If the object of the trust were to insure minority representation on the board, the trustees would be instructed to cast the trustee vote in favor of parties named by the designated minority interests up to such number of directors as were to be allowed the minority, the other members of the board being named by the majority interests. Or if the object of the trust were to secure an efficient and non-partisan board, the trustees might be merely instructed to cast the vote of the stock held by them for such persons as in their judgment would be suitable and acceptable to the interests involved. The trust agreement might also provide the manner in which the trustees' stock was to be voted

in matters of general interest, or it might be forbidden to vote on these matters, or its vote under such circumstances might be left to the discretion of the trustees.

Whatever the instructions, the stock must be voted as a unit by the trustees in accordance therewith, and in case of any refusal so to vote, provided the conditions of the trust be proper, the courts will enforce compliance.

The stock included in a voting trust is actually transferred to the trustees and is by them taken out in their own names. Trustees' receipts are given to the parties depositing stock, these receipts being negotiable in form and representing the equitable ownership of the stock held in the trust.

The trustees are authorized to collect and receive any dividends and profits accruing on the stock held by them, but must pay over the same in due proportion to the equitable owners of the trusteed stock.

The trust agreement also provides the method of dissolution of the trust upon the expiration of the specified time limit, and any other desired features or details. In order to avoid any possibly illegal suspension of the rights of alienation in the stock held in trust, the agreement may provide that at any time, by consent of all the parties in interest, the trust may be terminated. (Williams *vs.* Montgomery, 148 N. Y., 519, 1896.)

When it is only desired to control a single election, the use of proxies is the most convenient method by which this may be accomplished. These, being revocable and of limited duration, are not available for any permanent purposes.

§ 224. Legal Status.

New York is the only state of the Union in which the voting trust is expressly sanctioned by statute. This was done in 1901, when an amendment to the General Corporation Law was passed, providing:

> "A stockholder may by an agreement in writing, transfer his stock to any person or persons for the

> purpose of vesting in him, or them, the right to vote thereon for a time not exceeding five years upon terms and conditions stated, pursuant to which such person or persons shall act; every other stockholder, upon his request therefor may, by a like agreement in writing, also transfer his stock to the same person or persons and thereupon may participate in the terms, conditions and privileges of such agreement; the certificates of stock so transferred shall be surrendered and cancelled and certificates therefor issued to such transferee or transferees * * * " § 20, General Corporation Law.

Under the statute a duplicate of the voting trust agreement must be kept on file in the principal business office of the corporation, open to the inspection of any stockholder during business hours.

Prior to the passage of this statute, voting trusts existed in New York and were regarded favorably by the courts. (Williams *vs.* Montgomery, 148 N. Y., 519, 1896.) Since its passage, the conditions prescribed by the statute would probably have to be followed in detail to establish an enforceable trust.

In New Jersey (Chapman *vs.* Bates, 47 Atl. Rep., 638, 1900); Massachusetts (Brightman *vs.* Bates, 175 Mass., 105, 1900); California (Whitehead *vs.* Sweet, 126 Cal., 67, 1899); Alabama (Mobile, etc., Co. *vs.* Nicholas, 98 Ala., 92, 1893), and other states, although no statutes on this subject exist, the courts have rendered decisions favoring similar arrangements and intimating that where the trust was for a proper purpose and for a reasonable time, and did not contemplate any advantage from which other stockholders of the same corporation were excluded, it was not contrary to any principles of law or equity. It is probable that a voting trust, reasonable as to its duration and equitable as to its purposes, would be sustained in any state of the Union. (See Forms 13 and 14.)

§ 225. Requisites.

The primary requisite of a legally defensible and enforceable voting trust is that it be for some object not illegal in itself, or calculated to injure or discriminate against other stockholders of the same corporation. It must also be reasonable as to its duration and terms, and its possible advantages should be open to all stockholders of the particular corporation.

Any voting trust to promote a monopoly, or to dominate the corporation in the interests of another corporation, or to deprive other stockholders of any of their rightful powers, would be held illegal.

§ 226. Restriction of Stock Sales.

The voting trust as a means of restricting the sale of the stock held under its provisions is of doubtful efficacy. It unquestionably prevents the transfer of the actual stock during the life of the trust, and thereby prevents the transfer of any of the stockholders' rights that would accompany delivery of the stock. On the other hand, the trustees' receipts, or certificates, are transferable, and if the object of restricting the sale is to maintain the market price of the stock, or to give preference to the sale of treasury or other special stock, the sale of the trustees' certificates might interfere with these purposes almost as effectually as would the sale of the stock itself.

CHAPTER XXXVI.

PROTECTION OF MINORITY.

§ 227. General.

The corporate rights of minority stockholders are much circumscribed, are frequently ignored and are difficult of enforcement. Usually any proposed action of the board infringing upon these rights is not known to the minority until too late for prevention, and legal redress is, as a rule, slow, costly and inadequate. The proper protection of the minority is therefore on occasion a matter of much importance.

This protection is best secured by due provision at the time of incorporation. It is unfortunate that the interests which control at this time are too often indifferent or actually inimical to the rights of the minority and give them no consideration save as compelled by statute law, or by respect for the sensibilities of the investing public.

As a rule, however, the parties in control of the organization either voluntarily recognize the rights of the minority, or are compelled thereto by the conditions, and the minority may then secure efficient protection for such rights as are properly theirs.

§ 228. Rights of Minority at Common Law.

Under the common law the rights of the minority were not extensive. They were entitled to be present and participate at stockholders' meetings. They were entitled to inspect the corporate stock books during the usual hours of business and copy the names therein if they so desired. They also had the right under reasonable conditions to inspect the

books of account. Also a few important matters such as the amendment of the charter and the sale of the entire corporate assets required authorization by unanimous vote of the stockholders, and this requirement gave the minority a certain veto power in such matters. At stockholders' meetings the minority might assist in the deliberations but the majority had absolute power to adopt by-laws and to elect the entire board of directors. The minority might not even have a representative present at board meetings save by grace of the majority.

§ 229. Encroachment on Minority Rights.

There is in some quarters at the present time a certain trend toward the limitation and curtailing of the somewhat slender common law minority rights.

At common law the minority had the right at reasonable times to inspect the books and accounts of the corporation. This right has been so narrowed down by latter-day statutes and decisions that it is, in many states, negligible. In New Jersey, it is customary to limit this privilege still further to such inspection as the directors may prescribe. Even the stock and transfer books may only be seen under restrictions.

As to books of account, this change of custom is probably necessary, as otherwise business competitors might avail themselves of the formerly easily acquired right of inspection of the books to obtain information and trade secrets to the injury of the corporation. Also with the many stockholders and the complex accounts of modern corporations, the right, if freely exercised, would interfere with the regular transaction of business.

While this is true, some substitute for the stockholders' inspection of the books of account should be provided, that, without danger to the corporation, would give to the stockholders proper information as to the status of the corporate business. To deny it entirely is a flagrant and unjustifiable

disregard of the rights of those whose property it at stake. Also the abridgement of the stockholders' right to inspect the stock and transfer books is to be viewed with some distrust.

Again, the right to make by-laws was formerly a prerogative of the stockholders alone, and these by-laws usually imposed certain proper restraints and limitations upon the directors. Now, in New Jersey and a few other states, it is possible and not uncommon by charter provision to give the directors absolute power to repeal by-laws passed by the stockholders, and to substitute, if they so desire, by-laws of their own of exactly opposite effect. This is perhaps the most dangerous of all the innovations upon the old rules, as it virtually releases the directors from all necessity for compliance with the wishes of the stockholders and leaves in their hands the unrestrained management of the affairs of the corporation.

It will be understood without discussion that any change in the law acting to increase the powers of the directors, or to remove or prevent limitations thereon, distinctly augments the power of the majority. The board is elected by the majority and any restraining influences that exist, outside of the charter, by-laws and statutes, rest with this majority. If then the statutes are relaxed, charter limitations omitted and the board itself given the power to make and amend by-laws, the power of the board as the representative of the majority is greatly increased, and the minority becomes in effect a negligible quantity.

Also the charter may be more easily amended than formerly. In New Jersey such amendment may be accomplished by a two-third vote of the stockholders, in New York by a three-fifth vote, and in Delaware by a bare majority in interest. This latter is a somewhat remarkable relaxation of the former rule, and apparently permits a mere majority to change the entire nature of the corporate business, as for example, to divert capital invested for the purpose of

starting a printing business into the exploitation of a mining claim. It is doubtful whether material change in the charter should be allowed under any circumstances, unless by the practically unanimous vote of all concerned.

In consequence of these tendencies the present condition of the minority stockholder, unless special provision is made for his protection, is even less satisfactory than under the common law.

§ 230. Protective Measures.

The legitimate ends sought by the minority are honesty, efficiency and reasonable publicity of management—a management for the good of all and not in the interests of the majority alone.

The means that may be employed to secure these ends are of two general classes, the one consisting of such arrangements, modifications or restrictions of the voting power as to secure to the minority at least a reasonable representation on the board of directors; the other consisting of provisions in charter or by-laws restraining and regulating the powers of the board and prescribing safe rules for the conduct of the business.

The first-mentioned method is the most effectual for the protection of the minority interests. The usual cases of oppression or fraud on the part of the majority occur in the absence of minority representatives. If the minority have one or more directors on the board the majority will still, as a matter of course, control, but it is in the highest degree improbable that this control will be exercised to the injury of minority interests. If any such attempts are made, the minority will be fully cognizant of the proposed action, may enter such immediate protests and make such representations as they see fit, and, if such prejudicial action is persisted in, may take prompt legal action to protect their interests.

Without this board representation, charter and by-law provisions for the protection of the minority are apt to be of but

little effect. With the assistance of counsel skilled in evasion of the law, such unsupported provisions may be easily overcome or avoided. With an intelligent minority representation on the board such infringements of minority rights would not usually even be contemplated.

It is to be noted that in any state, as Delaware, where the constitution or statutes prescribe one vote for each share of stock held, no modification of the voting power can be effected.

The usual measures for the protection of minority interests are considered in the following sections of the present chapter.

§ 231. Cumulative Voting.

Cumulative voting is one of the most effectual means of securing minority representation on the board of directors. So highly are the results of this system esteemed that its use in corporate elections is prescribed by constitutional provisions in Pennsylvania, Illinois, California and a number of other states. In New York, New Jersey and some other states it may be used if so provided in the corporate charter. The Constitution of the State of Pennsylvania outlines the system with much conciseness, as follows:

> "In all elections for directors or managers of a corporation, each member or shareholder may cast the whole number of his votes for one candidate or distribute them upon two or more candidates as he may prefer."

The New York statutes go into the matter more fully:

> "The certificate of incorporation of any stock company may provide that at all elections of directors of such corporation, each stockholder shall be entitled to as many votes as shall equal the number of his shares of stock multiplied by the number of directors to be elected, and that he may cast all of such votes for a single director or may distribute them among the number to be voted for, or any two or more of

them as he may see fit, which right, when exercised, shall be termed cumulative voting."

Under this system the majority control and manage the corporation absolutely, but the minority will elect one or more directors to represent them. If they elect capable men there is but little danger that the minority interests will suffer.

To obtain the best results from cumulative voting the minority must be organized to some extent at the time of the annual election, and should delegate by proxy to some few trusted representatives the casting of their ballots.

To cast these aggregated votes to the best advantage sometimes requires nice calculation. For instance, in a corporation with a board of five directors and one hundred shares of voting stock, each share will have the right to cast five votes, or a total for all the voting stock of five hundred votes. In such case any person or persons controlling seventeen shares would cast eighty-five votes, and if this total vote were cast for a single candidate he would infallibly be elected. The aggregate of the other votes cast would be four hundred and fifteen, but no matter how they were divided among the other candidates, the candidate with eighty-five votes could not be defeated. If evenly divided among the five aspirants for board membership, each would receive eighty-three votes, but only four of these five could be elected, because the minority candidate, with eighty-five votes, would have a plurality of the votes cast.

There are no material objections to the system of cumulative voting, and it should be adopted wherever possible. Its increasing use is a practical testimonial to its value. It must, however, be used with intelligence, or the results are sometimes surprising. On occasion, an unsuspecting majority has so scattered its votes that a compact, well-handled minority has actually gained control of the board. In other words, the majority threw themselves into a minority by scattering. For instance, in the example given above, if the minority controlled forty-five shares of stock, they would be able to cast two hun-

dred and twenty-five votes as against two hundred and seventy-five votes cast by the majority. The minority might then very safely divide their votes among three candidates, with the assurance that they would elect at least two directors and might elect the third. The majority would have votes enough to elect three directors, but, if they thoughtlessly scattered those votes among four or five candidates, the three minority candidates, with over seventy votes each, would be elected and would control the board. Such an election, though somewhat unexpected in its results, is legal and would be upheld wherever cumulative voting is employed. (See § 113.)

§ 232. Classification of Stock.

Where definite divisions of interest exist among the stockholders, or intending stockholders, at the beginning of the corporate organization, classification of stock may in most states be employed with entire confidence that each class will receive due representation on the board. Such classification should be secured by charter provision where possible, elsewhere by by-laws adopted before stock is issued. Such by-laws so adopted become in effect a contract with those purchasing stock and hence are not susceptible of repeal save by consent of all interests. (Kent *vs.* Quicksilver Mining Co., 78 N. Y., p. 178, 1879.)

Under such an arrangement stock may be divided into any classes desired, equal or unequal in amount. To each of these classes may be assigned one or more directors, and so long as the corporate organization exists unchanged, each of these classes will elect its own directors to the board. This arrangement is very effective. Specific examples of its application are given in Sections 239 and 252 of the present volume. (See also § 98.)

§ 233. Voting Trusts.

The general subject of voting trusts is considered elsewhere. (See Chap. XXXV.) It is only referred to here as

a method of protecting minority rights where these interests are in a position to demand such protection before entering the corporation. This may occur where stock in a corporation is offered for sale, or where a partnership is to be incorporated with some of the partners holding comparatively small interests.

In such event, the proposed investment or arrangements may be acceptable to the parties concerned, even though the stock obtained is in a hopeless minority, if they can be assured of representation on the board, or that an acceptable management will be elected and retained for at least a reasonable length of time. In any such case the desired end may be effectually secured by means of the voting trust.

In this connection it may be noted that a mere agreement between parties holding stock that such stock shall be voted for certain persons or in a prescribed manner will not be enforced by the courts. Under some circumstances damages might be obtained for breach of such a contract, but the contract itself could not be enforced and damages would usually be very difficult to prove. (Gage *vs.* Fisher, 5 N. D., 297, 1895.)

§ 234. Special Arrangements.

Many other arrangements for the protection of the minority, or of particular interests are possible, depending upon the circumstances, the statutory provisions of the state of incorporation and the decisions of its courts.

In those states where special provisions may be inserted in the charter, it is entirely possible in the absence of express constitutional and statutory prohibitions to decrease the proportionate vote of stock as its holding increases, or to deny the voting right absolutely after a certain maximum vote has been reached. For instance, it may be provided that each stockholder shall cast one vote for each share of stock held by him up to a total of ten shares; that on stock in excess of this amount up to one hundred shares, he shall

have one vote for each five shares; that on all stock in excess of one hundred shares he shall have one vote for each ten shares. This is the voting provision of the English Companies Act which has some merits. Any other apportionment of the voting power may be made, or it may be provided that after some maximum vote has been reached, as for instance ten votes for ten shares held, no further vote shall be cast by such stockholder no matter what his holding.

It is also possible to place the number of votes necessary to elect a director so high that under any ordinary circumstances, directors cannot be elected save by agreement. For instance if a three-fourths' vote of the outstanding voting stock were necessary to elect, it would be but seldom that the majority could elect without minority assistance. Then they must either allow the management to remain without change, as will be the case if there is no election, or unite with the minority to elect. If this were necessary they would hardly propose anyone objectionable to the minority element. This plan presupposes an existing management acceptable to all the stockholders. (See § 236.)

§ 235. Annual Audits.

In the larger corporations the auditing of the books of account is a very important feature of the corporate operations, and, if properly conducted, may be made to eliminate any necessity for the inspection of such books by the rank and file of the stockholders. Such auditing may be annual, quarterly, or held at irregular intervals, and, if made by proper parties, serves both as a check on the management and a verification of their accounts. The results of these audits, expressed in such manner as to prevent the revelation of trade secrets, give the stockholders the general information in regard to the business that they have a right to demand, and, as has been stated, thereby remove the necessity for examination of the accounts by these latter. It is, of course, imperative that the professional accountants

employed as auditors be absolutely reliable and thoroughly qualified for their work.

§ 236. Charter Limitations.

In New York, New Jersey and some other states, limitations on the power of the majority may be inserted in the charter. At the inception of the enterprise, the minority are not infrequently in a position to demand the inclusion of such limitations as a condition precedent to their participation. Even if otherwise, an era of good feeling generally exists at this stage of the enterprise and reasonable concessions may then be obtained which later would not be possible.

An instance is afforded by the charter of one of the prominent industrial trusts in which the following provision is found:

> "It is hereby provided that it shall require a majority of seventy-five per cent. of the outstanding voting stock to amend the charter, to amend the by-laws, or to elect directors in this company."

Such a provision is directly in the interests of the minority. In this case it may have been conceded voluntarily, but probably its adoption was demanded by some of the smaller, but necessary, component corporations as one of the conditions of their entrance into the combination. Under such a provision no changes could be made in charter, by-laws or the board of directors against the wishes of a minority controlling twenty-six per cent. of the voting stock. Under such circumstances a minority judiciously handled could always protect its interests. This arrangement can not be had in New York as the statute specifies that directors shall be elected "by a plurality of the votes at such election."

As damage to minority interests, or the wrecking of corporations is almost invariably caused by improvident contracts, unwarrantable salaries, or excessive indebtedness, charter limitations upon the power of the board in these

directions are of frequent occurrence. Some flexibility is usually given to these restrictions by provision that their limits may be exceeded by a unanimous vote of the board, or by a two-thirds' or three-fourths' vote of the outstanding voting stock, or by some similar provision.

Where these limitations exist, it is important that some such flexibility be provided, as otherwise the interests of the corporation might on occasion suffer severely. Being charter provisions, their limits could not be legally exceeded by the corporation, either by action of the directors or stockholders except as specifically allowed by the charter, and business opportunities of obvious advantage to the corporation might be lost for lack of the power to meet their terms or conditions.

It is also possible to provide in the charter that the minority may have reasonable access to the books and records of the corporation, and any other desired privileges not in conflict with the statutes may be so secured. (See §§ 107, 116, 181 and 243.)

CHAPTER XXXVII.

PROTECTING AN INVENTOR.

§ 237. General.

A specific case that comes up frequently and is so typical in its nature as to merit special consideration is that of the inventor who desires to finance or exploit his invention under the corporate form, but fears that in the process he may be "frozen out," or in some other way defrauded of the profits he should enjoy. In practice these fears are frequently realized. In some instances it is due to his credulity, avarice or lack of business experience, which leads him to entertain impossible propositions, intended only to defraud the inventor or delude the public. In many cases, however, it is caused solely by the ignorance of the inventor as to how his interests may best be safeguarded and protected.

In this connection it may well be noted that investors in exploiting corporations have quite as often lost money through the unreasonable exactions, the mechanical failures and the lack of business judgment of inventors, as have these latter by the financial misdeeds of the former. As the exploiting corporation must be made safe and attractive to investors as well as to inventors, this condition has a direct bearing and must be kept in mind.

It is usually assumed that the men with money can protect themselves. This is generally true, and if the corporation as organized does not afford the proper protection the intelligent investor will either keep out, deal only on the basis of a control or insist on a reorganization. If, however, the corporation has been properly organized, with a view to the protection of both inventor and investors, these latter will be found much more

reasonable in their demands and more willing to agree to the due protection of the inventor.

Another feature which often affects the organization of exploiting corporations is the fact that inventors so frequently fall into the hands of professional promoters, who are much more concerned about promotion profits than they are about the protection of inventor or investor, or the future welfare of the undertaking. Under such conditions the inventor's interests are hardly worth protecting. Usually an enormously over-capitalized corporation appears, a few confiding investors are parted from their money, this is quickly absorbed by experimental work and general expenses, and, after a brief and futile existence, the corporation disappears.

It may be said that an invention, as a more or less speculative undertaking of undetermined value, is, when incorporated, entitled to a liberal capitalization, but this should be kept within the bounds of reason. Over-capitalization is distinctly injurious to the enterprise, is discouraging to intelligent investors and is frequently sufficient in itself to stifle the most hopeful invention.

Also, generally speaking, an unperfected or unpatented invention is not a proper or sufficient basis for an exploiting corporation. At this stage it is an entirely fit matter for private enterprise, but to incorporate on such an unsubstantial basis and offer stock for general investment approximates a fraud upon the public.

§ 238. Stock Control.

The usual procedure in the organization of a corporation to take over an invention is to issue all the authorized capital stock to the inventor, or to some trustee acting for the interested parties, in payment for the invention. The stock is thereby rendered nominally full-paid and non-assessable. Such portion of this stock as is to be actually retained by the inventor and the other parties interested with him, is reserved for the purpose and the balance of the stock is turned back to

the corporation, to be used in raising capital and for the general purposes of the company.

If the inventor is in a position to secure or retain a majority of the voting stock of the corporation and can keep this in his own hands or under his immediate control, he has the most efficient corporate protection that is possible. Through his power to elect a majority of the directors, he then has the entire management of the company and the enterprise in his own hands.

Directors elected under such circumstances are usually either associates, employees or friends of the party in control, he himself naturally being included among the number. There is no way in which these directors can be bound to carry out the wishes of the party electing them, and it therefore behooves such party to elect only directors in whom he can repose the utmost confidence. If he does make a mistake and one or more of his directors rebel, possibly throwing the majority of the board against him, he can usually do nothing but submit until the following annual election, when he may replace the objectionable directors by others more compliant. A small board is desirable where one party has the control, which he wishes to retain.

If the inventor is able to keep control of this company he should need no other safeguarding of his interests. If any protection is required it should be for the other parties. It is but rarely, however, that the inventor is in a position to retain control. Money is needed for the exploitation of his invention and this the inventor cannot usually supply. Stock must then be sold and the offering must be made attractive to investors. It is usually impossible to do this and retain control, and at this point the balance of power passes from the hands of the inventor. In this connection it may be stated that there is a prejudice, not entirely without foundation, against inventors as business men, and this fact would operate against the sale of stock in a corporation dominated by an inventor.

Where large individual investments are made, those who

invest expect to control as a matter of course. Where small investments can be secured in sufficient numbers to make up the required amount, the inventor's position is better, but even here such inducements must be offered the investor and such liberal compensation is demanded by the promoters, that the inventor seldom retains the corporate control.

§ 239. Classification of Stock.

In most states stock may be classified in several variations in protection of the inventor's interests. If there is no objection to his active control of the corporation, though the necessities of the case compel the disposition of a majority of its stock, this stock may be divided into two classes, the one being held by the inventor and his associates, the other being offered to the public or used in other ways. To the class retained by the inventor would be secured the election of the majority of the board of directors, the second class electing the remainder. The inventor would then elect a majority of the board of directors and thereby control.

For instance, if the corporation were capitalized at $100,000, of which the inventor was to retain $35,000, the number of directors being five, the stock might be divided into two classes, " A " and " B," of which class " A," consisting of $50,000 face value of the stock, elects three members and class " B " elects two. Then if the inventor received the greater part of class " A " he would control this class and thereby the corporation.

Or the stock might be divided into five classes, each equal as to amount and each electing one director. Each class would then consist of $20,000 face value of stock, and the inventor might easily so divide his holding of $35,000 among three of these classes that he would control each, thereby electing three directors and controlling the board. $12,000 of stock in each of two classes and $11,000 in the third would effectually secure this result.

Usually, however, control by the inventor is out of the

question, and the classification of stock when employed is merely intended to secure to the inventor—as an important minority stockholder—due representation on the board. Probably then the capitalization of $100,000 would be separated in two classes of $50,000 each, one electing two and the other three directors, and the inventor's $35,000 would be allotted him out of the first-named class. If so, he would unfailingly name two out of the five directors just so long as he retained control of his class.

To secure representation on the board is a very important matter in the protection of an inventor or any other minority interest, and, by classification of stock, such representation may be safely and permanently secured.

The results obtained by this classification may be carried further if desired, certain officers being elected by the directors of each class, as for instance one class electing the president and secretary, the other class the vice-president and treasurer, etc. It may also be provided that no change shall be made in charter or by-laws except with the consent of a majority of each of these classes. It is, however, seldom advisable to carry the matter to the extreme indicated even when possible, as complications and friction in the corporate machinery are too apt to result. (See §§ 98, 114, 232 and 252.)

§ 240. Voting Trust.

Where the inventor and those interested, or to be interested with him, can agree on a management acceptable to all, the voting trust offers a suitable and effectual means of maintaining such management for a term of years. It is obvious that any desired composition of the board may be maintained by this method. Specific parties may be elected, or a certain number of directors may be nominated by the inventor, or by the stock assigned the inventor, while the remaining directors are nominated by other interests, or left to the discretion of the trust. (See Chap. XXXV, Voting Trusts.)

§ 241. Cumulative Voting.

Where the inventor merely desires representation on the board of directors, it may usually be secured absolutely by the adoption of cumulative voting. This device is equally advantageous whether inventor or investor is in control, and is commonly employed. (See §§ 113 and 231.)

§ 242. Specified Majorities.

The inventor's interests may be efficiently protected in some lines by means of charter provisions requiring certain specific majorities for important actions of the stockholders, as, for instance, that the affirmative vote of two-thirds or three-fourths of the voting stock shall be necessary for the election of directors and the amendment of the by-laws. Unless prevented by statutory enactments, such an arrangement is possible in all those states where special charter provisions are allowed, and, elsewhere, might be secured by proper by-law provisions, so arranged as to become in effect a contract between the stockholders and the corporation.

In the incipiency of the organization the inventor should be able to secure any reasonable provisions of this kind that may seem to him desirable. It is also to be noted that the board elected at this time is usually selected by agreement and is acceptable to the inventor. The majorities required by the special provisions for the designated actions should be large enough to necessitate the concurrence of the inventor's stock before they can be secured. Then under these special provisions, neither charter nor by-laws may be amended, nor new directors elected save with the assent of the inventor and he need not assent to any change, or to any election of new directors, unless such change, or such new directors are entirely acceptable to him. It is within his power to maintain the *status quo* until he is satisfied that his interests will be benefited, or at least, not injured by a change.

§ 243. Limitation of Expenditures.

Corporations are usually wrecked, when such disaster occurs, by unwise or unwarranted expenditures. If then the power of the board to expend is so restricted by suitable charter or other provisions as to prevent this danger a considerable measure of protection is afforded. This is especially true in the case of an inventor holding a minority interest. If the board can neither increase salaries, nor make any expenditures above a certain sum, nor incur indebtedness in excess of a specified amount, except by such a majority as necessitates the inventor's concurrence, the wrecking of the corporation by intent would be difficult if not impossible. Circumstances must decide when such a measure is advisable. If the board is restricted too severely, such conditions may re-act and injure the business of the corporation. Such restrictions are not usually needed when a suitable board is in control. (See §§ 107, 116, 181 and 236.)

§ 244. Assignment of Patent to Trustee.

Under some circumstances the inventor may advantageously assign his patents to a trustee to hold for a term of years, giving rights to the corporation to manufacture thereunder in the meantime, with the condition that, at the expiration of that period, the patents shall be assigned the corporation in case it has a certain paid-in capital, is not in debt, has paid certain dividends, or has accomplished some other specified results, otherwise, the trustee to reassign to the inventor.

This plan may be so modified to meet the varying conditions as to be a perfect protection of the inventor's interests. It is, however, usually objectionable, inasmuch as it leaves the corporation, in the absence of other assets, with only a conditional right to the patent, and, therefore, in no condition to sell its stock or to obtain credit. No one would wish to invest money in or extend credit to a corporation which may have

valuable patents if it complies with certain conditions, but otherwise will have nothing. For this reason the plan is seldom practicable.

§ 245. Reservation of Royalties.

Probably the safest arrangement for the inventor is the reservation of a royalty, with a prescribed minimum annual production or utilization. When the patent rights are assigned with this condition incorporated in the assignment and this assignment is properly recorded with the Commissioner of Patents, the royalty follows the patent, and, no matter who holds the rights, such holder must pay the specified royalties and be governed by the general conditions of the assignment.

It is, of course, always possible under this arrangement that the corporation, or its assigns or successors, may, in the interests of competitors, merely operate to the annual minimum required by the assignment and go no further. This danger is, however, remote and the annual minimum may usually be fixed at such an amount as to practically secure the inventor against any such possibility, or render its occurrence a matter of minor importance. The minimum might be made to increase from year to year at a specified ratio.

Under this arrangement the inventor cannot interfere with the management so long as his royalties are paid, and on the other hand, it is not possible for other interests to secure the patent without the royalty obligation to the inventor. This latter should, as a matter of course, have some contract provision for the examination of the records that will show what the utilization of his patent really is, and the date and manner of payment of royalties should be clearly specified. The penalty to ensue if royalties are not paid should also be specifically provided. It may be arranged that in such case the control of the business shall pass to the inventor, or that the patents revert to him. In the absence of any specific arrangement, he will have the somewhat inadequate remedy of a suit for damages.

CHAPTER XXXVIII.

INCORPORATING A PARTNERSHIP.

§ 246. General.

The incorporation of partnerships involves problems differing from those of the incorporation of a new enterprise. These problems vary with the conditions and requirements of the particular partnership.

If the partners are willing to adopt the simplest and most obvious corporate arrangements; if they will capitalize at the actual values; issue all the capital stock in payment for the values transferred to the corporation; allot this full-paid stock to the various partners in the proportion of their partnership interests, and thereafter let matters take their natural corporate course, the duties of the incorporating counsel are not onerous. Usually, however, the parties to such an incorporation are not willing to commit themselves so irrevocably to the operations of the unmodified corporate system. They are accustomed to the conditions of the partnership, and they wish these approximated as nearly as may be under the new regime. Possibly all the partners, without regard to investment, may be participating equally in the management, or one partner, with a relatively small investment, may be the leading spirit and practically in control, or a silent partner, taking no active part in the management, may have a preponderant investment. In any of these cases, the ordinary operations of the corporate system would work a radical change, and it is not to be supposed that the partners would agree to the entire abolition of the conditions under which they have achieved success. On the contrary, the existing conditions must be continued. This may be done with much precision, for nowhere does the flexi-

bility of the corporate system appear to better advantage than in its ready adjustment to the varying needs of partnership incorporations.

§ 247. Name.

The partnership name should in itself represent a considerable trade value that would be lost if it were dropped on incorporation. To avoid this, the name of the partnership is usually adopted, as nearly as may be, as the name of the new corporation. In those states where permitted the partnership name is not infrequently taken without modification as the corporate designation. This practice is, however, open to objection, as there is then nothing in the corporate name to indicate that the concern is a corporation, and parties doing business with it might, unless informed of its corporate nature, be able to hold the stockholders as partners.

Such a possibility largely eliminates the most advantageous single feature of incorporation—its limited liability—and to retain this feature, while still preserving the actual form of the partnership name, the word " Incorporated " is frequently added to this latter. This usually appears in small letters below or after the name, sometimes in parenthesis, and effectually prevents any danger of partnership liability.

In some states the word " Company " must form part of every corporate name, and in these states the usual practice is to adopt the partnership name with the word company following, Smith & Jones becoming on incorporation the Smith & Jones Company. This practice is very common in all the states, whether required by law or otherwise, and is generally preferable to the use of the unmodified firm name, or its use in connection with the word " Incorporated."

Another common modification of the firm name is to substitute a hyphen for the connecting word and add " Company," Smith & Jones then becoming the Smith-Jones Company. In most of the states the prefix " The " either may or may not be made part of the corporate name, though in a few states its

use is obligatory. Owing to the additional length given the corporate name by its use, and its exceeding awkwardness in certain legal constructions, the word " The " is better omitted unless there are special reasons for its retention. (See Chap. XIV, The Corporate Name.)

§ 248. Capitalization.

If the business is to go on under the corporate form just as before, without sale of stock to outsiders, the simplest, and possibly most satisfactory basis of capitalization, is the actual value of the assets turned in to the new corporation, without allowance for good-will, trade name or any other intangible assets. Then on incorporation each partner will participate in the stock by which this capitalization is represented to the amount of his existing partnership investment.

Under this plan the capital stock of the new company is kept at a comparatively low figure, taxation is to some extent avoided, while the respective proportionate interests of the different partners are accurately preserved. As will be readily seen, no very exact estimate of the value of the business is necessary under this arrangement. The capital stock merely serves as a convenient method of adjusting the proportionate interests of the partners, and no matter what its amount, these interests are still represented in proper proportion.

If, however, new members are to be taken into the incorporated business, or any of the partners expect to sell stock, or it is anticipated that at any time in the near future stock will change hands, the proper valuation and capitalization of the business become matters of considerable importance. Then the value of the good-will should be added to the property values; also any other intangible assets, such as trade names, trade marks and copyrights should be included at a fair figure. All of these are valuable assets and are legitimately represented in the capitalization of the business.

Any desired property may, of course, be reserved to the partnership. If the partners wish to retain a portion of the

cash on hand, or certain portions of the firm realty or other property, or think certain accounts better in their own hands, the whole matter is in their discretion. They may retain what they will and transfer what they will.

The form of capitalization is also a matter of conditions and discretion. It may be all common stock, or, if desired, preferred stock and bonds may be added. The matter rests entirely with the partners. If it is decided to issue bonds the corporate capitalization will naturally be reduced by just that amount. If preferred stock is issued, the common stock will be reduced by that amount, but the total capitalization will remain the same.

If additional capital is needed for the business of the new corporation, and stock must be sold to secure it, the amount of capitalization determined by the total value of the partnership assets—including good-will—would be increased by the amount of stock to be so sold.

§ 249. Exchange of Property for Stock.

The value of the partnership business and property having been determined, and the capitalization of the corporation fixed at this total value, the business, as a going concern, will be offered to the new corporation in exchange and full payment for all its capital stock. This offer should be by formal written proposition, which would usually be signed by one of the partners with the firm name, but might be signed by all the partners.

This proposition is usually accepted without demur, the new corporation authorizing the issue of its capital stock in payment for the property. The capital stock will then be issued in accordance with the terms of the proposition, and the partnership business and property as tendered will be transferred to the corporation, usually by formal bill of sale, though sometimes by mere delivery of possession, and the transaction as between the partnership and the corporation is

complete. (See Chap. XXXII, Issuance of Stock for Property.)

The corporation then owns the business as transferred to it, but the partnership still exists, with the stock as its sole asset, unless some of the partnership property has been reserved from the sale to the corporation. The distribution of this stock among the partners in accordance with previous agreements, or usually in proportion to their respective firm interests, completes the usefulness of the partnership. It may then be continued in a quiescent condition, be dissolved by formal agreement, or merely be allowed to lapse. If no partnership property was reserved and the stock received by the firm is distributed, and there are no special reasons for its continuation, dissolution by formal agreement is the better practice, avoiding any possibility of subsequent entanglements or liabilities. If it is desired to avoid all possible liability under the old firm, formal notice should be given, by mail or publication, of the incorporation of the business and the dissolution of the partnership.

§ 250. Stock Adjustments.

In an ordinary partnership when the investments are equal, or nearly so, the stock received in exchange for the partnership property would usually be all common stock and would be distributed among the partners in equal proportion. If, however, the interests were not equal, or special conditions were to be met, this very simple arrangement might be varied almost indefinitely.

At times preferred stock is desired by the partners to represent a portion, at least, of the property transferred by them to the corporation. Such stock has the advantage of its fixed preferential dividend that must be paid if any profits are made, and it may be given any other stock powers or privileges deemed necessary.

At other times the partners will prefer to have a portion of the property transferred to the corporation paid for by

bonds. Corporate taxation is usually thereby avoided though personal taxation may be proportionately increased. Beyond this, bonds are a safe and very convenient form of corporate security to hold if the incorporated business is, in whole or in part, going into new hands.

A silent partner's interest might be properly provided for by a preferred stock, drawing a preferential dividend equal to the rate of interest theretofore paid upon his investment, or participating otherwise in profits to the same extent as his investment did before. This preferred stock might be allowed to vote, or if it were not desirable that the silent partner should participate in the management, the voting right might be denied, or his entire interest might be provided for by an issue of bonds which would draw a fixed rate of interest without regard to profits, but could not vote.

If one partner's investment were much larger than that of other partners, but equality in management were desired in the new corporation, such excess interest might be provided for by non-voting preferred stock, by a bond issue, or by an issue of common stock without the voting right. In the latter case such partner would participate in all profits on the basis of the full amount of stock held by him but would not vote on the excess portion. If his excess investment were in bonds he would vote and participate in dividends on the basis of the amount of stock actually received by him, but would receive in addition the fixed amount of interest called for by his bonds. Also at some specified date he would receive payment of the face of his bonds, his excess investment under these conditions constituting a preferred claim against the corporate property. Under the preferred stock plan, he would participate in profits to the full on his quota of common stock, but on this preferred stock would, presumably, only participate in profits to the extent of his preferred dividend. The final redemption of such preferred stock might or might not, according to the arrangement, take precedence over any

liquidation of the common stock. (See Chap. VIII, Preferred Stock.)

§ 251. Board of Directors.

If the partners take the amount of stock in the new corporation to which their respective firm interests entitle them and let the selection of the board take its natural course thereafter, the matter is simple. Usually, however, the partners wish an equality of power in the board, or a specified representation, or a classification or some other arrangement, and the composition and method of electing the board of directors frequently becomes the most difficult question arising in the incorporation of a partnership.

Where equality of power is desired each partner will usually designate one or more directors so that the completed board will contain an equal number of representatives for each partner. Where the partnership consists of three or more, the usual practice is to make the number of directors equal to the number of partners, elect all the partners, or the chosen representatives of any partners not wishing to appear on the board, and then make provision for the maintenance of the board so constituted. (See § 252.)

Where there are two partners, the matter is less easily arranged. Three is the minimum number of directors usually allowed, and the necessity of having a third director who really has the deciding vote in any point of difference makes the situation difficult. Sometimes a confidential clerk, or a mutual friend, or the wife of one of the partners is chosen, but in event of any difference, the result is apt to be very unsatisfactory. If possible, a mutual friend of character and standing may be elected with the understanding that he is not to be involved or troubled in any way unless serious difference arises, when he will virtually act as an arbitrator. Another plan is to have some indifferent person accept the office and immediately resign, leaving the third position vacant with the two partners in control to fight

out any differences just as they would have done in the days of partnership. If this plan were objectionable on account of the incomplete condition of the board, the membership of the directorate might be fixed at four, each partner being elected to the board and designating an additional member. Arbitration might be provided for in case of a deadlock.

§ 252. Maintenance of Agreed Management.

When the composition and manner of election of the board of directors has once been decided, some means of securing the permanency of the agreed arrangement is usually desirable. If mere representation of the minority interest on the board is desired, this may usually be secured by the adoption of cumulative voting. In some states, however, cumulative voting is not permissible, and in many cases more than minority representation is desired. Other means must then be adopted. Some of these are as follows:

(a) By Voting Trust.

The voting trust is often the most satisfactory means of preserving the agreed status of corporate management, the members of the old partnership usually constituting the membership of the trust.

The objections to the voting trust for such a purpose are its limited duration and the fact that the stock owned by the partners is itself locked up in the trust, and, for purposes of sale, or other use, must be represented by trustees' certificates.

In New York the life of a voting trust is by statute expressly limited to five years, and it is doubtful whether the arrangement could be enforced or continued save by mutual consent for a longer period. In states where there is no legislative provision in regard to the voting trust, it is probable that a trust for the purposes of maintaining an agreed management would be sustained for any reasonable period, as ten or even more years.

In case of the formation of a voting trust the actual assignment of the stock to the trustees cannot be avoided. Irrevocable proxies would be practically impossible under the usual conditions. The owners of the stock must therefore content themselves with trustees' certificates. For holding and for some other purposes these certificates would not be objectionable. For selling or for use as collateral they would not be as available as the stock itself. (See Chap. XXXV, Voting Trusts.)

(b) By Voting Requirements.

In most states where special charter provisions are allowed, it may be provided that any desired majority shall be necessary for the election of directors and this majority may be made so large—even up to the unanimous vote of all the outstanding voting stock—that the agreed status of the board can only be disturbed by the active consent of all interested parties. Deadlocks may occur at times under such a provision but their only effect would be to leave the board in statu quo, thus maintaining the agreed arrangement but dispensing with the election.

It would be but rarely advisable or wise to require unanimous consent to the election of directors. The same ends may be practically secured by a two-thirds or three-fourths majority and the danger of factious opposition by holders of a small number of shares is thereby avoided. (See § 242.)

It is to be noted that under this arrangement in event of the death or resignation of a director, the interests for which such director stood would be unrepresented on the board and could only regain such representation by consent of sufficient stock to make up an electing majority. This objection to the plan would under some conditions be fatal.

(c) By Classification of Stock.

The classification of stock offers a very permanent method of maintaining a representative directorate. Each

partner's stock may be constituted a class with some convenient arbitrary designation, as "Class A," "Class B," or "Class 1," "Class 2," etc., and each one of these classes may be endowed with the right to elect one or more directors. If desired, one class may be allotted a greater number of directors than others, though usually each class is allowed equal power as to the number of directors it may elect.

For instance, in the incorporation of a partnership with property and other assets of the estimated value of $100,000, of which $50,000 belongs to one partner, $30,000 to a second and $20,000 to a third, it might be desired that the same equal participation in the management that characterized the partnership should be continued in the corporation. This might be effected with absolute certainty by a division of the stock into three classes, $50,000 in the first, $30,000 in the second and $20,000 in the third, and giving to each class the right to elect one-third of the membership of the board. Each partner would then be given all of one of these classes of stock, and, notwithstanding their very unequal interests in the business, each would elect one-third the total number of directors. If it were not desired to secure this absolute equality in the management of the business but merely to insure representation to the two minority partners, this stock might be classified as before, the first class being given say three directors of a board of five and the second and third classes one each, or any other apportionment deemed expedient might be made.

Under this system the interests holding any one class are absolutely sure that so long as they hold their stock intact, or *hold a clear majority of it,* they can elect their allotted membership of the board, and that in no other way than by the purchase of at least a majority of their stock can this representation be wrested from them. It is obvious that the plan is capable of considerable variation to fit the conditions of any particular case.

A modification of this plan where equal representation is

desired is to divide the classified voting stock equally among the partners and then issue preferred stock without the voting power to cover the excess of investment of any partner. Also, where more capital is desired, such non-voting preferred stock may be sold without interfering with the original division of power. (See § 98.)

§ 253. Officers.

In the conversion of a partnership into a corporation little difficulty is usually experienced in the selection of officers, the partners taking these positions, and their previous habits, duties and positions in the firm designating with more or less precision the official position for which each is best fitted.

It may be noted, however, if there is difficulty in the assignment of the official positions, that outside of a few matters specified or implied by the statutes of some states, the powers and duties of officers may be fixed absolutely by charter or by-laws. In New Jersey for instance, the certificates of stock must be signed by the president and treasurer, certain reports must be signed by designated officials, and other matters of minor importance are required of specified officials. Beyond this, however, the corporation is free to authorize its officers as it deems best. The power of the president may be so restricted that he is incapable of independent action, any desired limitations may be placed upon the power of the treasurer, the secretary may be assigned any powers or duties that the conditions seem to require, and any or all of these officers may be made as dependent upon or independent of the board and of their fellow officers as may be deemed expedient.

Usually it is not the part of wisdom to vary the usual powers and relations of the corporate officers but occasionally in the adjustment of partnership relations under the corporate form such changes may be made to advantage.

CHAPTER XXXIX.

HOLDING CORPORATIONS.

§ 254. General.

A holding corporation in the modern sense of the term is a corporation formed for the express purpose of controlling other corporations by the ownership of a majority of their stock.

Under the common law, which did not permit one corporation to invest in the stock of another, holding corporations were impossible.[1] The common law rule has, however, been gradually relaxed and set aside until now the purchase of stocks by a corporation may be provided for in most states of the Union. The courts have held that corporations such as insurance companies which necessarily receive large amounts for investment, may as a consequence of the conditions and without specific authorization, purchase stocks in other corporations. Also, any corporation is allowed to take stock to save a debt, or, where stock has been deposited with it as collateral and then forfeited, to retain and hold such forfeited stock.

The general right to purchase and hold the stock of other corporations, under which the holding corporation is possible, is, however, derived from legislative enactment, either by virtue of statutes expressly conferring on corporations the power to buy and hold the stocks of other corporations, or under the operation of statutes permitting the formation of corporations for any legitimate purpose.

§ 255. Statutory Enactments.

New Jersey was the first state to enact statutes specifically empowering corporations organized under its laws

[1] People *vs.* Pullman Co., 175 Ill., 125 (1898), 64 L. R. A., 366.

to hold the stock of other corporations. This law was adopted in the year 1888, and reads as follows:

> "Any corporation may purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of the shares of the capital stock of, or any bond, securities or evidences of indebtedness created by any other corporation or corporations of this or any other state, and while owner of such stock may exercise all the rights, powers and privileges of ownership, including the right to vote thereon." § 51, The General Corporation Law of New Jersey.

The enactment of this law by New Jersey paved the way for the great industrial combinations. Theretofore they had been attempted by the appointment of a board of trustees in whose hands was placed a majority of the stock of the corporation to be controlled, these trustees then electing boards of directors who managed their respective corporations in the common interest. This arrangement was declared illegal and has been abandoned for the holding corporation under the New Jersey law. (See State *vs.* Standard Oil Co., 49 Ohio St., 137, 1892.) (People *vs.* North River Sugar Refining Co., 121 N. Y., 582, 1890.)

Delaware and Maine have enacted statutes similar to those of New Jersey, permitting corporations to buy, hold and sell stocks, and in New York these privileges may be enjoyed if so provided in the charter.

§ 256. Present Status.

At the present time the holding corporation occupies a position of great importance, being the means by which many of the great industrial combinations have been formed and are now controlled. Sometimes these corporations are confined strictly to the function of holding companies, as in the case of the Northern Securities Company which was formed solely to hold sufficient stock of the Great Northern Railway Company and the Northern Pacific Railway Com-

pany to control the two companies and combine their interests. Usually, however, such a corporation is given, in addition, ample powers to carry on directly any business or industry in the line of the proposed combination. Then it can operate by controlling the majority of the stock of its component corporations, or by buying up the manufacturing plants engaged in the particular industry, or by initiating new industrial operations on its own account, or by doing all of these things. The United States Steel Corporation has such a charter as this which is given in full in Part VII of this work. (See Chap. XL, "Industrial Combination.")

It is possible for the holding corporation itself to be controlled by the ownership of but fifty-one per cent. of its stock, and so long as the parties in control hold this amount they can part with any additional stock without interfering with their control of the holding corporation and through it of the subsidiary corporations. This device makes it possible for those who are on the inside to control much capital with a comparatively small investment on their own part. For a full discussion of this subject see Robotham *vs.* Prudential Insurance Co., 53 Atl. Rep., 842 (1903); 1 Cook on Corporations, §317, and Noyes on Intercorporate Relations, §285 *et seq.*

§ 257. Limitations.

The holding corporation is the instrument by which most of the great industrial combinations have been effected and is generally recognized as the proper legal means to this end. In some cases, however, these corporations may be found to violate provisions of the laws against combinations and monopolies. It is also more than possible that some of the states may pass laws to prevent foreign holding corporations from controlling corporations formed under the laws of such states.

In the recent Northern Securities case, the United States courts held the attempt to prevent competition between two opposing interstate railways by means of a holding corporation

illegal. (See Northern Securities Co. *vs.* United States, 193 U. S., 197, 1903.)

In any case of abuse of power by means of a holding corporation, the courts would undoubtedly afford relief. (See Farmers' Loan and Trust Co. *vs.* N. Y., etc., R. Co., 150 N. Y., 410, 1896; Niles *vs.* N. Y. C. & H. R. R. Co., 69 App. Div., N. Y., 144, 1902.)

§ 258. Parent Companies.

A useful variant of the holding company is frequently employed with advantage in the exploitation of inventions. A parent corporation, in which the patent rights for such inventions are vested, is formed in some selected state where the power to hold the stock of other corporations may be had. Subordinate companies are then formed in the several states or other territorial districts, and to these companies rights in the invention are assigned for their respective districts, the parent company usually reserving or acquiring a controlling interest in each subordinate company. The patent rights may be sold absolutely, or with reservation of royalties, or merely a license may be issued. The subordinate company then operates in its own territory as an independent company, but under the general direction of the parent company, this direction becoming immediate and absolute in case of necessity.

Under this plant the parent corporation makes certain the proper fulfilment of its contracts with the subordinate companies, and also the proper and harmonious conduct of the general business.

For a discussion of this subject see People *vs.* Am. Bell Telephone Co., 117 N. Y., 241 (1889.)

CHAPTER XL.

INDUSTRIAL COMBINATION.

§ 259. General.

The modern industrial combination is an aggregation of corporations of like or collateral purposes, with such various additions to or modifications of the powers and holdings of the central or controlling corporation as may be dictated by the particular conditions. The term "trust," by a somewhat singular verbal perversion, is applied colloquially to such a combination to express the idea that it controls a sufficient proportion of the industry affected to give it more or less of monopolistic powers.

In former days combinations of this kind were effected by placing the controlling stock interests of the various corporations in the hands of trustees, who by this means elected the majority of the directors of each corporation, and through the compliant boards thereby secured dictated the policy and details of management for each corporation. Thus competition was avoided and such co-operation secured as was deemed necessary.

This arrangement was, however, summarily and effectively checked by the adverse decisions of the courts, and recourse was then had to the unity secured by combining all the desired interests under one dominating central corporation. This method now prevails. The controlling corporation may acquire the properties and businesses of the subordinate corporations outright, thereby effecting a consolidation, or may purchase a majority interest in the stock of each one, thereby controlling their operations, or a combination of these methods may be employed. In any event, the result is the same, the

absolute domination and direction of the business and policy of each of these subordinate corporations by the central power.

The combinations so secured are, when properly arranged, very effective, are upheld by the courts, and apparently withstand successfully the varied anti-trust legislation of the different states of the Union.

The organization of large combinations of this kind is a difficult and complicated undertaking, demanding the most skillful promotion, able financing, experienced and resourceful counsel and general business and executive ability of the highest order. A brief resumé of the usual procedure is given in the following sections:

§ 260. Preliminaries.

In some instances the initiative in forming an industrial combination has been taken by the leaders of the particular industry. It is but seldom, however, that such a combination has been carried through by these leaders. They are too fully occupied, lack the wide experience, and, possibly, the financial position, essential to the formation of a large combination. Men who occupy the same relative position in the financial world that these leaders do in the industrial world are usually requisite to success.

Not infrequently the movement for a combination will be inaugurated by men entirely outside the industry involved, these men being actuated by the exceptionally rich emoluments that have rewarded the promoters of successfully-effected combinations. These promoters may be financiers who have the ability to secure the co-operation of the representative men of the industry in which the combination is to be effected, or they may be parties of no great financial weight themselves, but able to interest both financiers and the leaders of the particular industry in the combination proposed. In any event, if the combination is to be successful, the co-operation of the leading men of the industry is essential, and, on the other side, the active participation of men of sufficient position

to finance the proposed combination, either directly or indirectly, is equally essential.

Some combinations have come to pass as the resultant of unsuccessful " pools," " gentlemen's agreements " and other ineffctive devices of the kind. These were too loose, too unmanageable and too easily broken to accomplish the desired purpose, and have been abandoned in favor of the stronger, more effective and permanent corporate combination.

Usually the details of any proposed combination are mapped out in advance, possibly by the promoters and the leading men of the particular industry involved, or by a committee appointed for the purpose by the interested parties. In any event, a careful preliminary investigation of the whole matter is most essential. Such an investigation, carried out thoroughly and intelligently, should demonstrate almost conclusively the possibilities of the proposition—should determine if the plan is practicable, if so, under what conditions, and whether these conditions can be met. If the results of such investigation are sufficiently encouraging, the general plan of action will be arranged by the parties in charge, a working organization of some kind effected among themselves and the actual work begun.

§ 261. Option Agreements.

In the incipiency of the combination option contracts occupy a most important position. These are in effect agreements between the promoters of the proposed combination and the owners of the desired properties, defining the terms upon which these properties may be brought into the combination. A large combination could hardly be formed without their employment, and generally speaking, the greater the number of desirable options secured and the better their terms, the greater the possibilities of success for the combination and the larger the profits of promotion.

In this work the genius of the promoter has full play and much depends upon his ability and efficiency. The best possi-

ble terms must be obtained from those willing to enter the combination, and unwilling owners, by persuasion, argument and even covert threats, must be brought into line. In some cases the demands of owners are extravagant and unjustifiable, and it then frequently becomes a matter of nice judgment whether their demands shall be acceded to or they shall be left out, temporarily at least. It is at times easier to deal with such cases after the actual formation of the trust.

Sometimes conditional options are secured on a few of the most important plants of a particular industry before any other attempt is made to formulate the trust. These options are then made the basis upon which the lesser plants are invited to enter the combination.

Occasionally options are taken without accurate appraisement or other valuations, the parties in charge being willing to take the properties in on the owner's terms. Usually, however, the option price is contingent on verification by subsequent inspection and appraisement. Or the price is left contingent on the results of such later inspection and appraisement.

These options may be on the plants direct, or on a sufficient stock interest in the corporations to carry their control. Sometimes options on the stock will include an agreement by the directors and stockholders to sell the entire assets of the company. The option prices are usually made, as far as possible, payable in the stock or other securities of the combination.

§ 262. Inspection and Appraisements.

In the organization of any large combination, the inspection and appraisement of the various properties and businesses involved is a matter of much difficulty and of the greatest importance. Expert accountants go over the books and accounts of the various concerns and compile carefully itemized reports, going back a number of years and showing the business done, the expenses and the profits, as well as the existing conditions. Appraisers meanwhile take careful and detailed inventories of

the plants and stocks with full estimates and valuations. In both cases the investigations are extensive in their range and the reports embodying their results should be accurate as to fact and conservative as to deduction. Condensed and tabulated statements are made from these reports.

These tabulations are used for two general purposes; the one, to determine the actual values of the properties and the basis upon which they may be properly taken into the trust; the other, which is even more important, to determine what net income is likely to result from the united properties when operated under the economies possible to such a combination.

The combinations made during the past few years have been generally over-capitalized, mainly because, in nearly every case, the calculations were predicated upon the few years immediately preceding, which had been years of great prosperity for all manufacturing interests. It is probable that the accountants and appraisers did their work in these cases with entire correctness, but the data and the estimates drawn therefrom, being based on exceptional conditions, were misleading when applied to a future to which these exceptional conditions did not extend.

It has also since become evident that the economies of combination were generally exaggerated, and that in some cases, instead of destroying competition, the conditions under which the combinations were formed necessitated an increase of prices to a point that actually stimulated competition. The over-capitalized trusts were then the principal sufferers in the industrial war they had themselves provoked.

It need hardly be said that, while the general industrial conditions preceding and existing at the time of the formation of a trust should be given full weight in its capitalization and general arrangement, such conservative allowance should also be made for the years to come, that, no matter what the conditions, short of an industrial crisis, the combination will survive in good condition. If this is done the combination is a safe one. If not, it is intrinsically unsound.

§ 263. Underwriting.

In all important combinations of late years underwriting has been an important feature. The obvious purpose of this underwriting is to assure the sale of the combination's securities. In most, if not all cases, an equally important purpose is the immediate cash to be secured thereby.

Any large combination is practically impossible without considerable amounts of ready cash. Payments must be made on options. Debts or bonds that encumber desired properties must be paid. The direct organization expenses are heavy. When the properties are taken over, large payments are usually required. An adequate operating capital is a necessity. Most, if not all, of these demands must be met before money can be secured from the public by the sale of stock or other securities of the combination.

The underwriting meets this emergency effectually. The underwriters themselves may agree to pay or advance certain amounts of cash on their underwriting. Usually, however, the money is secured from some financial institution on the strength of the underwriting and the pledges of the incipient combination, or of its trustees. If the underwriting is responsible and sufficient in amount the necessary cash is readily secured.

The underwriting, if made by suitable parties, is also a strong endorsement of the combination. It means that if the public do not buy the securities offered by the trust the underwriters will, and, if these underwriters are responsible, their opinion, as indicated by this obligation, has great weight with the investing public. The successful organization of the great modern industrial combinations could hardly have been achieved without the ready financial aid afforded by the modern system of underwriting. (See Chap. XXXIV, Underwriting.)

§ 264. **Organization.**

The general rule in large combinations is to issue preferred stock to the value of the actual property assets, and then issue common stock in addition up to the estimated earning powers of the combination. As in recent years the earning capacity has been usually estimated on the basis of preceding prosperous years, with a too liberal addition to cover the savings resulting from the supposed economies of trust management, the common stock of most of the later trusts has generally depreciated and has little value, except as derived from its voting power.

Bonds are not usually issued at the time of organization, unless there are existing bonds or other obligations on some of the desired properties or corporations which must be taken up by bonds of the combination. If issued, interest must be paid when due, regardless of profits or losses, and this necessarily may result in disaster. Also, the bonds themselves must be redeemed at maturity, and this may be difficult. It is, therefore, a recognized rule that bonds must only be issued, if at all, in a very small proportion to the capitalization. The Shipyard Trust is the only prominent example in which this prudent rule was openly and flagrantly disregarded, and here the very unfortunate results testify forcibly to the soundness of the general rule.

The charter will probably be taken out under the laws of New Jersey, these laws having been expressly framed to permit the formation and convenient operation of corporate combinations doing business in many states. (See § 24.)

The final organization of a trust does not differ from that of any other incorporation and proceeds along the lines indicated in Chapters XXX to XXXII of the present volume. Temporary incorporators and directors are the rule, though, in the incorporation of the Carnegie Steel Company and a few other combinations of importance, the real parties in interest participated in the first organization. (See Charter Forms, Part VII.)

PART VII.—FORMS AND PRECEDENTS.

CHAPTER XLI.

CHARTER FORMS.

Form 1.—Connecticut Charter.

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CERTIFICATE OF INCORPORATION

of

THE NATIONAL PUBLICITY CORPORATION.

We, the subscribers, certify that we do hereby associate ourselves as a body politic and corporate, under and by virtue of the provisions of an act of the General Assembly of the State of Connecticut, entitled "An Act Concerning the Formation of Corporations," being chapter 157 of the Public Acts of 1901, and all acts amendatory thereof; and we further certify:

First—That the name of the corporation is

"THE NATIONAL PUBLICITY CORPORATION."

Second—That said corporation and its principal office or place of business is to be located in the Town of Hartford, in the State of Connecticut.

Third—That the nature of the business to be transacted and the purposes to be promoted or carried out by said corporation are as follows:

(*a*) To act as and carry on the general business of advertising agents and to engage in and conduct the business of advertising in all its branches, including the preparation and arrangement of advertisements and advertising matter of all kinds; the purchase, preparation, manufacture, utilization and disposal of advertising toys, pictures, devices, novelties, inventions and all other means and instrumentalities for advertising; the acquisition and preparation of advertising space and facilities, mural and of independent construction, and the letting and selling of space and privileges upon the same, and the purchase and utilization of all letters patent, patent rights, trademarks and copyrights pertaining to or useful in the conduct of the said business of advertising.

(*b*) To buy, sell, manufacture and deal generally, as printers, publishers, stationers, engravers, designers, booksellers and proprietors and publishers of newspapers, magazines, periodicals, literary works and publications and printed and illustrated matter of all kinds and descriptions.

(*c*) To engage generally in the art, trade and business of photographic printing, photo-engraving, lithographing and all other modes

of reproducing or producing printing, engraving, drawings, paintings, pictures and representations and impressions of all kinds, in color or otherwise.

Fourth—That the amount of the capital stock of said corporation hereby authorized is two thousand dollars ($2,000). divided into twenty (20) shares, of the par value of one hundred dollars ($100) each.

Fifth—That said corporation will commence business with a capital stock of one thousand dollars ($1,000).

Sixth—That no period is hereby limited for the duration of said corporation.

Seventh—Signature of incorporators:

NAMES.	RESIDENCES.
Adam M. Johnson	City and State of New York.
William C. Kelsey	City and State of New York.
James L. Sands	City and State of New York.

Dated at New York this 14th day of July, 1904.

(Affidavit of incorporators to truth of certificate.)

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Form 2.—Delaware Charter.

.....

CERTIFICATE OF INCORPORATION

of the

INTERSTATE BISCUIT COMPANY.

First—The name of this corporation shall be

"INTERSTATE BISCUIT COMPANY."

Second—Its principal office in the State of Delaware shall be located in the City of Wilmington and County of New Castle. The agent in charge thereof shall be Philip L. Garrett.

Third—The objects and purposes for which this corporation is formed are to do any and all of the things herein set forth, as fully and to the same extent as natural persons might or could do, and in any part of the world, namely:

(*a*) To manufacture, buy, sell, pack, prepare and generally to deal in and with biscuits, crackers, cakes, Italian paste, confectionery, cereals, coffees, teas, dried fruits, and foods and food products and materials of all kinds, either raw or manufactured, that may be used in foods and food products and beverages, or for the packing, adapting, preparing or preserving of such foods, food products or beverages; and generally to mix, adapt, refine, prepare, preserve, manufacture and dispose of all such goods, wares, merchandise and materials, either in original packages or in such cans, jars, boxes, cartons or other containing packages as may be found desirable.

(*b*) To purchase, lease or otherwise acquire lands, buildings, tenements and factories in Delaware or elsewhere, for the plants, offices, workshops, warehouses, laboratories and manufactories of the Company, and to purchase, lease or otherwise acquire tools, implements, engines, machinery, apparatus, fixtures and conveniences of all kinds for the manufacture, manipulation, preparation, preserva-

tion, packing and handling of the materials and products of the Company.

(*c*) To apply for, obtain, purchase, lease or otherwise acquire, and to register, hold, own and use any and all trademarks, trade secrets, processes, formulæ, inventions and improvements capable of being used in connection with the work of the Company, whether secured under letters patent in the United States, or elsewhere or otherwise; and to use, operate and manufacture under the same, and to sell, assign, grant licenses in respect of or otherwise dispose of and turn the same to the account and profit of the Company.

(*d*) To do any and all things set forth in this certificate as objects, purposes, powers or otherwise to the same extent and as fully as natural persons might do, and in any part of the world, as principals, agents, contractors, trustees or otherwise, and either alone or in company with others.

(*e*) To have offices, conduct its business and promote its objects within and without the State of Delaware, in other States, the District of Columbia, the territories and colonial dependencies of the United States, and in foreign countries, without restriction as to place or amount.

Fourth—The amount of the total authorized capital stock of this corporation is Five Hundred Thousand Dollars ($500,000), divided into five thousand (5,000) shares of the par value of One Hundred Dollars ($100) each.

The amount of capital stock with which this corporation will commence business is the sum of One Thousand Dollars ($1,000).

Fifth—The names and residence of each of the original subscribers to the capital stock are as follows:

NAMES.	RESIDENCES.
Francis G. Fawcett	Pittsburgh, Pa.
Randolph C. Blythe	Pittsburgh, Pa.
A. C. Bentley	Philadelphia, Pa.

Sixth—The existence of this corporation shall be perpetual.

Seventh—The private property of the stockholders shall not be subject to the payment of corporate debts to any extent whatever.

Eighth—The Directors shall have power to make, alter, amend and repeal the By-Laws; to fix the amount to be reserved, and to authorize and cause to be executed mortgages and liens, without limit as to amount, upon the property and franchises of this corporation.

With the consent in writing, and pursuant to a vote of the holders of a majority of the capital stock issued and outstanding, the Directors shall have power and authority to dispose, in any manner, of the whole property of this corporation.

The Directors shall from time to time determine whether and to what extent the accounts and books of this Corporation, or any of them, shall be open to the inspection of the stockholders; and no stockholder shall have any right of inspecting any account, or book, or document of this Corporation, except as conferred by law, or the By-Laws, or by resolution of the stockholders.

The stockholders and Directors shall have power to hold their meetings and keep the books, documents and papers of the Corporation outside of the State of Delaware, at such places as may be from time to time designated by the By-Laws or by resolution of the stockholders or Directors, except as otherwise required by the laws of Delaware.

It is the intention that the objects, purposes and powers specified in the third paragraph hereof shall, except where otherwise expressed in said paragraph, be nowise limited or restricted by reference to or in inference from the terms of any other clause or paragraph in this certificate of incorporation, but that the objects, purposes and powers specified in the third paragraph and in each of the clauses or paragraphs of this charter shall be regarded as independent objects, purposes and powers.

We, the undersigned, for the purpose of forming a corporation under the laws of the State of Delaware, do make, file and record this certificate, and do certify that the facts herein stated are true; and we have accordingly hereunto set our respective hands and seals, this seventeenth day of February, A. D. 1904.

FRANCIS G. FAWCETT. [SEAL.]
RANDOLPH C. BLYTHE. [SEAL.]
A. C. BENTLEY. [SEAL.]

In presence of

(Acknowledgment in due form.)

.....

Form 3.—Maine Charter.

.....

ARTICLE OF AGREEMENT

of

THE MARCHMONT DRUG COMPANY.

We, the undersigned, hereby associate ourselves together for the purpose of forming a corporation under the laws of Maine.

First—The name of the said corporation shall be

"THE MARCHMONT DRUG COMPANY."

Second—The purposes for which it is to be formed are:

(1) To acquire and take over from the Marchmont Drug Corporation, a corporation under the laws of New Jersey, but having its factory and principal place of business in the City of New York, the recipes and formulæ for and information as to the processes of manufacturing and preparing and the right to prepare, manufacture and deal in the proprietary articles and medicines owned by the said New Jersey corporation, together with the trade names, trademarks and patented preparations owned by said corporation, and all its plant, factory and offices held under lease in said City of New York, and all the apparatus and appliances and materials therein contained.

(2) To buy, sell, refine, prepare, manufacture, manipulate, import, export and deal in and with all substances, materials, apparatus and things capable of being used in connection with the preparation and manufacture of the articles and remedies which this company may become entitled to prepare and manufacture, and to construct, maintain and alter any plant, buildings or factories and laboratories suitable or convenient for the purposes of the company.

(3) To carry on the business of chemists, druggists, chemical manufacturers, importers, exporters and dealers in chemical, pharmaceutical, medicinal and other preparations and chemicals.

Third—Said corporation shall be located and shall have its principal office at Portland, in the County of Cumberland and State of Maine.

Fourth—We do hereby waive all statutory requirements as to notice of the first meeting for organization, and hereby call such first meeting for the 8th day of November, 1904, at 3 o'clock P. M., at the office of Wellman & Shields, in Portland, Maine, and we hereby consent to the transaction of all such business as may come before said meeting or at any adjournment thereof.

Dated this 27th day of October, 1904.

MORTON RHOADES.
LOUIS HOFFMAN.
ROBERT W. STYLES.

.....

The foregoing articles are sent to Maine, accompanied by the subscriptions of the parties for one share each of stock, with proxies signed by these parties in blank. Four residents of Maine are then introduced into the matter, likewise sign the articles, subscribe for one share each of stock and the blank proxies are made out to one or more of them as convenient. These Maine parties, being a majority of the incorporators and holding proxies from all the other incorporators, are fully empowered to act and hold the first meeting.

This meeting adopts by-laws, fixes the amount of capital stock and elects directors and officers. A certificate of organization is then prepared, is signed by the officers and filed in the office of the Secretary of State. The corporate existence begins from the date of filing of this certificate, which is in form as follows:

.....

STATE OF MAINE.

CERTIFICATE OF ORGANIZATION OF A CORPORATION UNDER THE GENERAL LAW.

The undersigned, officers of a corporation organized at Portland, Maine, at a meeting of the signers of the articles of agreement therefor, duly called and held at the office of Wellman & Shields, in the City of Portland, on Tuesday, the 8th day of November, A. D. 1904, hereby certify as follows:

The name of said corporation is

"THE MARCHMONT DRUG COMPANY."

The purposes of said corporation are:

(As set forth in Articles of Agreement.)

The amount of capital stock is One Hundred Thousand Dollars ($100,000).

The amount of common stock is One Hundred Thousand Dollars ($100,000).

The amount of preferred stock is nothing.

The amount of capital stock already paid in is nothing.
The par value of the shares is One Hundred Dollars ($100).
The names and residences of the owners of said shares are as follows:

NAMES.	RESIDENCES.	NO. OF SHARES.
Morton Rhoades	New York, New York	1
Louis Hoffman	New York, New York	1
Robert W. Styles	New York, New York	1
Wm. P. Darby	Portland, Maine	1
H. C. Fisher	Portland, Maine	1
Thos. Ashby	Portland, Maine	1
Oliver Haines	Portland, Maine	1
Number of shares of stock unsubscribed		993
Total number of shares of stock		1,000

Said corporation is located at Portland, in the County of Cumberland.
The number of directors is three and their names are Wm. P. Darby, H. C. Fisher and Thos. Ashby.
The name of the Clerk is Wm. P. Darby and his residence is Portland.
The undersigned H. C. Fisher is President; the undersigned Thos. Ashby is Treasurer; and the undersigned Wm. P. Darby, H. C. Fisher and Thos. Ashby are a majority of the directors of said corporation.
Witness our hands this ninth day of November, A. D. 1904.

H. C. FISHER, President.
THOS. ASHBY, Treasurer.
WM. P. DARBY,
H. C. FISHER, } Directors.
THOS. ASHBY,

(Affidavit of directors in due form.)
(Certificate of Attorney-General that the certificate is conformable to Maine law.)

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Form 4.—South Dakota Charter.

.....

ARTICLES OF INCORPORATION
of
ANDES EXPLORATION AND DEVELOPMENT COMPANY.

Know All Men By These Presents:

That we, the undersigned, George N. Wright, James Powers and John E. Evans, for ourselves, our associates and successors, have associated ourselves together for the purpose of forming a corporation under and by virtue of the statutes and laws of the State of South Dakota, and we do hereby certify and declare as follows, viz.:

First—The name of this corporation shall be

"ANDES EXPLORATION AND DEVELOPMENT COMPANY."

Second—The purpose for which this corporation is formed is to conduct the business of:

1. Mining, smelting, refining, reducing and dealing in and with all sorts of ores, metals, minerals, and the prospecting, locating,

opening, operating and developing of mines, oil wells, quarries and mineral deposits of all descriptions.

2. Constructing and operating mills, factories, machine shops and industrial plants of all descriptions, and the buying, selling and dealing in and with all supplies, merchandise and materials, raw or prepared, useful or convenient, in connection therewith.

3. Establishing and conducting savings institutions, loan, trust and investment companies, and guarantee and insurance institutions, either directly or indirectly, in such form and manner as the laws may permit.

4. Farming, planting and tilling the soil and the operating of farms, ranches, orchards, plantations and haciendas, and all industries appurtenant thereto.

5. Constructing and operating tramroads, canals, irrigating systems, steamboats, steamships and ships and vessels of all kinds.

6. Buying, selling, leasing and improving lands, town sites and territories, and laying out, plotting, subdividing and colonizing the same.

Third—The place where the principal business of this corporation shall be transacted is Pierre, in the County of Hughes and State of South Dakota, but a branch office may be located at New York City, where said corporation may hold meetings of its stockholders and directors, and the said corporation may do business in any part of the world.

Fourth—The term for which this corporation shall exist shall be twenty (20) years.

Fifth—The number of directors of this corporation shall be five (5), and the names and residences of such, who are to serve until the election of their successors, are as follows:

NAMES.	RESIDENCES.
George N. Wright	New York City, N. Y.
James Powers	New York City, N. Y.
Henry Decker	Brooklyn, N. Y.
John E. Evans	Pierre, S. D.
Richard Conley	Pierre, S. D.

Sixth—The amount of the Capital Stock of this Corporation shall be and is Two Million Five Hundred Thousand Dollars ($2,500,000), divided into Two Hundred and Fifty Thousand (250,000) Shares, of the par value of Ten Dollars ($10) each.

In Testimony Whereof, we have hereunto set our hands this 12th day of August, 1904.

(Signed) GEORGE N. WRIGHT.
JAMES POWERS.
JOHN E. EVANS.

(Acknowledgments in due form.)

(Special affidavit by two incorporators that incorporation is in good faith, and not to avoid the provisions of the South Dakota anti-trust laws.)

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CHAPTER XLII.

SPECIAL CHARTERS.

Form 5.—New York Charter (Midvale Realty).

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CERTIFICATE OF INCORPORATION

of the

MIDVALE REALTY CORPORATION.

We, the undersigned, all being of full age and two-thirds being citizens of the United States and one of us a resident of the State of New York, for the purpose of forming a corporation under the Business Corporations Law of the State of New York, do hereby certify and set forth:

First—The name of said corporation shall be

"MIDVALE REALTY CORPORATION."

Second—The purposes for which said corporation is to be formed are as follows:

(Purposes omitted.)

Third—The amount of capital stock of said corporation shall be one million dollars ($1,000,000).

The amount of capital with which said corporation will begin business is one thousand dollars ($1,000).

Fourth—The number of shares of which said capital stock is to consist shall be ten thousand (10,000) shares, of the par value of one hundred dollars ($100) each.

Of said capital stock five thousand (5,000) shares, of the par value of five hundred thousand dollars ($500,000) shall be cumulative preferred stock, entitled to an annual dividend of six per cent. (6%) from the profits of the corporation, payable semi-annually, on the tenth days of January and July in each year, before any dividends are paid upon the common stock, and to share equally with the common stock in any excess paid in any year above six per cent. (6%) to all the stock, and in the event of liquidation or dissolution from any cause said preferred stock shall be entitled to be paid in full from the assets of the corporation before anything is paid to the common stock. The holders of such preferred stock shall not be entitled to vote in any meeting of the stockholders or election of directors, unless the accumulated dividends due and unpaid such preferred stock at the time shall equal or exceed fifteen per cent. (15%) of the par value of said stock.

Of said capital stock five thousand (5,000) shares, of the par value of five hundred thousand dollars ($500,000) shall be common stock of the corporation.

Fifth—The principal business office of said corporation shall be located in the Borough of Manhattan and in the City, County and State of New York.

Sixth—The duration of said corporation shall be perpetual.

Seventh—The number of directors of said corporation shall be five.

Eighth—The names and post-office addresses of the directors of said corporation for the first year are as follows:

(Names and addresses of directors omitted.)

Ninth—The names and post-office addresses of the subscribers to this certificate, and the number of shares which each agrees to take in said corporation are as follows:

NAMES.	ADDRESSES.	SHARES.
John B. Clark.....	203 Broadway, New York City.....	1
Charles F. Holbrook....	Mount Vernon, N. Y.....	1
Douglas Raymond	212 Madison Ave., New York City.....	1

Tenth—At all elections of directors of this corporation each stockholder shall be entitled to as many votes as shall equal the number of his shares of stock, multiplied by the number of directors to be elected, and he may cast all of such votes for a single director or may distribute them among the number to be voted for, or any two or more of them, as he may see fit.

In Witness Whereof, we have made and signed this certificate in duplicate this 13th day of October, one thousand nine hundred and four.

(Signatures of incorporators.)

(Notarial acknowledgment in due form.)

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Form 6.—New Jersey Charter (United States Steel).

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AMENDED CERTIFICATE OF INCORPORATION

of

UNITED STATES STEEL CORPORATION.

We, the undersigned, in order to form a corporation for the purposes hereinafter stated, under and pursuant to the provisions of the Act of the Legislature of the State of New Jersey, entitled "An Act Concerning Corporations (Revision of 1896)," and the acts amendatory thereof and supplementary thereto, do hereby certify as follows:

I.—The name of the corporation is

UNITED STATES STEEL CORPORATION."

II.—The location of its principal office in the State of New Jersey is at No. 51 Newark street, in the City of Hoboken, County of Hudson. The name of the agent therein and in charge thereof, upon whom process against the corporation may be served, is Hudson Trust Company. Said office is to be the registered office of said corporation.

III.—The objects for which the corporation is formed are:

To manufacture iron, steel, manganese, coke, copper, lumber and other materials, and all or any articles consisting or partly consisting of iron, steel, copper, wood or other materials, and all or any products thereof.

To acquire, own, lease, occupy, use or develop any lands containing coal or iron, manganese, stone or other ores, or oil, and any woodlands, or other lands, for any purpose of the company.

To mine or otherwise to extract or remove coal, ores, stone and other minerals and timber from any lands owned, acquired, leased or occupied by the company, or from any other lands.

To buy and sell, or otherwise to deal or to traffic in, iron, steel, manganese, copper, stone, ores, coal, coke, wood, lumber and other materials and any of the products thereof, and any articles consisting or partly consisting thereof.

To construct bridges, buildings, machinery, ships, boats, engines, cars and other equipment, railroads, docks, slips, elevators, water works, gas works and electric works, viaducts, aqueducts, canals and other waterways, and any other means of transportation, and to sell the same, or otherwise dispose thereof, or to maintain and operate the same, except that the company shall not maintain or operate any railroad or canal in the State of New Jersey.

To apply for, obtain, register, purchase, lease or otherwise to acquire, and to hold, use, own, operate and introduce, and to sell, assign, or otherwise to dispose of, any trademarks, trade names, patents, inventions, improvements and processes used in connection with or secured under letters patent of the United States, or elsewhere, or otherwise; and to use, exercise, develop, grant licenses in respect of, or otherwise turn to account any such trademarks, patents, licenses, processes and the like, or any such property or rights.

To engage in any other manufacturing, mining, construction or transportation business of any kind or character whatsoever, and to that end to acquire, hold, own and dispose of any and all property, assets, stocks, bonds and rights of any and every kind, but not to engage in any business hereunder which shall require the exercise of the right of eminent domain within the State of New Jersey.

To acquire by purchase, subscription or otherwise, and to hold or to dispose of stocks, bonds or any other obligations of any corporation formed for, or then or theretofore engaged in or pursuing any one or more of the kinds of business, purposes, objects or operations above indicated, or owning or holding any property of any kind herein mentioned; or of any corporation owning or holding the stocks or the obligations of any such corporation.

To hold for investment, or otherwise to use, sell or dispose of, any stock, bonds or other obligations of any such other corporation; to aid in any manner any corporation whose stock, bonds or other obligations are held or are in any manner guaranteed by the company, and to do any other acts or things for the preservation, protection, improvement or enhancement of the value of any such stock, bonds or other obligations, or to do any acts or things designed for any such purpose; and, while owner of any such stock, bonds or other obligations, to exercise all the rights, powers and privileges of ownership thereof, and to exercise any and all voting power thereon.

The business or purpose of the company is from time to time to do any one or more of the acts and things herein set forth; and it may conduct its business in other States and in the Territories and in foreign countries, and may have one office or more than one office, and keep the books of the company outside of the State of New Jersey, except as otherwise may be provided by law; and may hold, purchase, mortgage and convey real and personal property either in or out of the State of New Jersey.

Without in any particular limiting any of the objects and powers of the corporation, it is hereby expressly declared and provided that the corporation shall have power to issue bonds and other obligations in payment for property purchased or acquired by it, or for any other

object in or about its business; to mortgage or pledge any stock, bonds or other obligations, or any property which may be acquired by it, to secure any bonds or other obligations by it issued or incurred; to guarantee any dividends or bonds or contracts or other obligations; to make and perform contracts of any kind and description; and in carrying on its business, or for the purpose of attaining or furthering any of its objects, to do any and all other acts and things, and to exercise any and all other powers which a copartnership or natural person could do and exercise, and which now or hereafter may be authorized by law.

IV.—The total authorized capital stock of the corporation is eleven hundred million dollars ($1,100,000,000), divided into eleven million shares of the par value of one hundred dollars each. Of such total authorized capital stock five million five hundred thousand shares, amounting to five hundred and fifty million dollars, shall be preferred stock, and five million five hundred thousand shares, amounting to five hundred and fifty million dollars, shall be common stock.

From time to time the preferred stock and the common stock may be increased according to law, and may be issued in such amounts and proportions as shall be determined by the Board of Directors and as may be permitted by law.

The holders of the preferred stock shall be entitled to receive, when and as declared, from the surplus or net profits of the corporation, yearly dividends at the rate of seven per centum per annum and no more, payable quarterly on dates to be fixed by the by-laws. The dividends on the preferred stock shall be cumulative, and shall be payable before any dividends on the common stock shall be paid or set apart; so that, if in any year dividends amounting to seven per cent. shall not have been paid thereon, the deficiency shall be payable before any dividends shall be paid upon or set apart for the common stock.

Whenever all cumulative dividends on the preferred stock for all previous years shall have been declared and shall have become payable, and the accrued quarterly installments for the current year shall have been declared, and the company shall have paid such cumulative dividends for previous years and such accrued quarterly installments, or shall have set aside from its surplus or net profits a sum sufficient for the payment thereof, the board of directors may declare dividends on the common stock, payable then or thereafter, out of any remaining surplus or net profits.

In the event of any liquidation or dissolution or winding up (whether voluntary or involuntary) of the corporation, the holders of the preferred stock shall be entitled to be paid in full both the par amount of their shares and the unpaid dividends accrued thereon before any amount shall be paid to the holders of the common stock; and, after the payment to the holders of the preferred stock of its par value and the unpaid accrued dividends thereon, the remaining assets and funds shall be divided and paid to the holders of the common stock according to their respective shares.

V.—The names and post-office addresses of the incorporators, and the number of shares of stock for which severally and respectively we do hereby subscribe (the aggregate of our said subscriptions, being three thousand dollars, is the amount of capital stock with which the corporation will commence business), are as follows:

NAME.	POST-OFFICE ADDRESS.	NUMBER OF SHARES. PREFERRED STOCK.	NUMBER OF SHARES. COMMON STOCK.
Charles C. Cluff	51 Newark St., Hoboken, N. J.	5	5
William J. Curtis	51 Newark St., Hoboken, N. J.	5	5
Charles MacVeagh	51 Newark St., Hoboken, N. J.	5	5

VI.—The duration of the corporation shall be perpetual.

VII.—The number of Directors of the company shall be fixed from time to time by the by-laws; but the number, if fixed at more than three, shall be some multiple of three. The Directors shall be classified with respect to the time for which they shall severally hold office by dividing them into three classes, each consisting of one-third of the whole number of the Board of Directors. The Directors of the first class shall be elected for a term of one year; the Directors of the second class for a term of two years, and the Directors of the third class for a term of three years; and at each annual election the successors of the class of Directors whose terms shall expire in that year shall be elected to hold office for the term of three years, so that the term of office of one class of Directors shall expire in each year.

The number of Directors may be increased as may be provided in the by-laws. In case of any increase of the number of the Directors the additional Directors shall be elected as may be provided in the by-laws, by the Directors or by the stockholders at an annual or special meeting; and one-third of their number shall be elected for the then unexpired portion of the term of the Directors of the first class, one-third of their number for the unexpired portion of the term of the Directors of the second class, and one-third of their number for the unexpired portion of the term of Directors of the third class, so that each class of Directors shall be increased equally.

In case of any vacancy in any class of Directors through death, resignation, disqualification or other cause, the remaining Directors, by affirmative vote of a majority of the Board of Directors, may elect a successor to hold office for the unexpired portion of the term of the Director whose place shall be vacant, and until the election of a successor.

The Board of Directors shall have power to hold their meetings outside of the State of New Jersey, at such places as from time to time may be designated by the by-laws or by resolution of the Board. The by-laws may prescribe the number of Directors necessary to constitute a quorum of the Board of Directors, which number may be less than a majority of the whole number of the Directors.

Unless authorized by votes given in person or by proxy by stockholders holding at least two-thirds of the capital stock of the corporation, which is represented and voted upon in person or by proxy at a meeting specially called for that purpose or at an annual meeting, the Board of Directors shall not mortgage or pledge any of its real property, or any shares of the capital stock of any other corporation; but this prohibition shall not be construed to apply to the execution of any purchase-money mortgage or any other purchase-money lien. As authorized by the Act of the Legislature of the State of New Jersey, passed March 22, 1901, amending the 17th section of the Act Concerning Corporations (Revision of 1896), any action which theretofore required the consent of the holders of two-thirds of the stock at any meeting after notice to them given, or required their consent in writing to be filed, may be taken upon the consent of, and the consent given and filed by the holders of two-thirds of the stock of each class represented at such meeting in person or by proxy.

Any officers elected or appointed by the Board of Directors may be removed at any time by the affirmative vote of a majority of the whole Board of Directors. Any other officer or employee of the company may be removed at any time by vote of the Board of Directors, or by any committee or superior officer upon whom such power of removal may be conferred by the by-laws or by vote of the Board of Directors.

The Board of Directors, by the affirmative vote of a majority of the whole Board, may appoint from the Directors an executive committee, of which a majority shall constitute a quorum; and to such extent as shall be provided in the by-laws, such committee shall have and may exercise

all or any of the powers of the Board of Directors, including power to cause the seal of the corporation to be affixed to all papers that may require it.

The Board of Directors, by the affirmative vote of a majority of the whole Board, may appoint any other standing committees, and such standing committees shall have and may exercise such powers as shall be conferred or authorized by the by-laws.

The Board of Directors may appoint not only other officers of the company, but also one or more Vice-Presidents, one or more Assistant Treasurers, and one or more Assistant Secretaries; and to the extent provided in the by-laws the persons so appointed respectively shall have and may exercise all the powers of the President, of the Treasurer and of the Secretary, respectively.

The Board of Directors shall have power from time to time to fix and to determine and to vary the amount of the working capital of the company; and to direct and determine the use and disposition of any surplus or net profits over and above the capital stock paid in; and in its discretion the Board of Directors may use and apply any such surplus or accumulated profits in purchasing or acquiring its bonds or other obligations, or shares of its own capital stock, to such extent and in such manner and upon such terms as the Board of Directors shall deem expedient; but shares of such capital stock so purchased or acquired may be resold, unless such shares shall have been retired for the purpose of decreasing the company's capital stock, as provided by law.

The Board of Directors from time to time shall determine whether and to what extent, and at what times and places, and under what conditions and regulations, the accounts and books of the Corporation, or any of them, shall be open to the inspection of the stockholders, and no stockholder shall have any right to inspect any account or book or document of the Corporation, except as conferred by statute or authorized by the Board of Directors, or by a resolution of the stockholders.

Subject always to by-laws made by the stockholders, the Board of Directors may make by-laws, and, from time to time may alter, amend or repeal any by-laws, but any by-laws made by the Board of Directors may be altered or repealed by the stockholders at any annual meeting, or at any special meeting, provided notice of such proposed alteration or repeal be included in the notice of the meeting.

In Witness Whereof, we have hereunto set our hands and seals the 23d day of February, 1901.

CHARLES C. CLUFF. [L. S.]
WILLIAM J. CURTIS. [L. S.]
CHARLES MACVEAGH. [L. S.]

Signed, sealed and delivered in the presence of

FRANCIS LYNDE STETSON.
VICTOR MORAWETZ.

(Acknowledgment.)

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Form 7.—New Jersey Charter (Chicago Subway).

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*Certificate of Incorporation

of

CHICAGO SUBWAY COMPANY.

The undersigned, for the purpose of forming a corporation under and pursuant to an Act of the Legislature of the State of New Jersey, entitled "An Act concerning Corporations (Revision of 1896)," and the acts amendatory thereof and supplemental thereto, do hereby set out and certify as follows:

Article First—The name of the corporation is

"CHICAGO SUBWAY COMPANY."

Article Second—The location of the principal office of the corporation in the State of New Jersey is at No. 15 Exchange place, in the City of Jersey City, County of Hudson, in said State, which shall also be its registered office. And the name of the agent of said corporation in said State, who is in charge of said principal office and upon whom process against this corporation may be served, is the Corporation Trust Company.

Article Third—The objects for which the corporation is formed are as follows, viz.:

To furnish, transmit, convey, transport and deliver sounds, signals and intelligence, packages, mail matter, freight and general merchandise, power, heat, light and refrigeration, by steam, water, air, electricity or otherwise, and to acquire, construct, dispose of, hold, maintain, operate and lease to, or rent from others, all tunnels and other subways and space therein, and all terminals, structures, appliances and other property, real or personal, useful in carrying out any lawful purpose whatsoever; to produce or otherwise acquire and to furnish and distribute electric current or other mechanical power, for light, heat, power, refrigeration, signaling, traction or other purposes, both public and private; to operate a telephone exchange and system; to operate a system for the delivery of parcels and messages by messengers, vehicles, or otherwise; to carry on the business of storage and warehousing in all its branches; to construct and operate subways, tunnels, pneumatic tubes, telephone systems, telegraph lines, power houses, terminals and other structures incidental to any of the purposes herein enumerated; to construct, control, lease and operate, by electricity or other power, railways for the transportation of passengers or freight; to produce, manufacture and to otherwise prepare and to deal in and deal with any materials, machinery, appliance, supplies or products which may be used in or in connection with any of the objects aforesaid; to hold, purchase or otherwise acquire, to sell, assign, mortgage, pledge or otherwise dispose of the shares of the capital stock, bonds or other evidences of debt incurred or created by other corporations, and while the holder of such stock, to exercise all the rights and privileges of ownership, including the right to vote thereon, to the same extent as a natural person might or could do; to apply for, obtain, register, lease or otherwise acquire, and to hold, use, operate, sell, assign or otherwise dispose of, any trade-marks, trade-names, patents, inventions, improvements and

* By courtesy of the Corporation Trust Company

processes used in connection with or secured under letters patent of the United States, or of any other countries, or otherwise; and to carry on any other business whatsoever which the corporation may deem proper or convenient to be carried on in connection with any of the foregoing purposes, or calculated directly or indirectly to promote the interests of the corporation or to enhance the value of its property, and to have and enjoy and exercise all the rights, powers and privileges which are now or which may hereafter be conferred upon corporations organized under the act herein mentioned; provided, always, that the corporation shall not construct, maintain or operate any railroad or telegraph or telephone lines in the State of New Jersey, or engage in any business hereunder which shall require the exercise of the right of eminent domain within said state, unless power in either or any of said respects shall hereafter be conferred upon it by law; nor shall anything herein set forth be construed to authorize or evidence the formation hereby of an insurance, safe deposit or trust company, banking corporation, savings bank or other corporation deemed to possess any of the powers prohibited to corporations formed under the statutory provisions aforesaid.

The purpose of the corporation is from time to time to do any one or more of the acts and things herein set forth.

The corporation may, from time to time, conduct its business in other states and in the territories, District of Columbia and dependencies of the United States, and in foreign countries; it may have an office or offices, and, except as otherwise required by law, keep its books, in whole or in part, at a point or points outside of the State of New Jersey; and it may hold, purchase, mortgage and convey real and personal property in any such state, territory, district, dependency or foreign country.

Without in any particular limiting or restricting any of the objects and powers of the corporation, it is hereby expressly declared and provided that the corporation shall have power to issue bonds and other obligations in payment for property purchased or acquired by it, for money borrowed, or for any other lawful object in and about its business; to mortgage or pledge any property which may be acquired by it; to secure any bonds, guarantees or other obligations by it issued or incurred; to guarantee any dividends, bonds, contracts or other obligations; to make and perform contracts of every kind and description; and in carrying on its business, or for the purpose of attaining or furthering any of its objects or purposes, to do any and all other things and exercise any and all other powers which now or hereafter may be permitted by law.

Article Fourth—The total authorized capital stock of the corporation is Fifty Million Dollars ($50,000,000), divided into Five Hundred Thousand (500,000) shares of the par value of One Hundred Dollars ($100) each.

Article Fifth—The names and post-office addresses of the incorporators, and the number of shares of stock for which, severally and respectively, the said incorporators do hereby subscribe (the aggregate of our said subscriptions being Five Thousand Dollars, which is the amount of capital stock with which the corporation is authorized to commence business), are as follows:

NAME.	POST-OFFICE ADDRESS.	NO. OF SHARES.	TOTAL PAR VALUE.
Howard K. Wood	15 Exchange Place, Jersey City, N. J.	20	$2,000
Horace S. Gould	15 Exchange Place, Jersey City, N. J.	20	2,000
Kenneth K. McLaren	15 Exchange Place, Jersey City, N. J.	10	1,000

Article Sixth—The duration of the corporation shall be perpetual.

Article Seventh—The number of directors of the corporation shall be fixed and may be increased or decreased as may be provided, from time to time, in the by-laws. In case of any increase in the number of directors, the additional directors shall be elected as may be provided in the by-laws by the directors or by the stockholders at an annual or special meeting. The corporation shall have the power, at any time, to provide for the classification of its Board of Directors and to do all things by it deemed necessary or proper to accomplish such classification. In case of any vacancy in the Board of Directors, the remaining directors, by an affirmative vote of the majority of the Board of Directors, may elect a successor to hold office for the unexpired portion of the term of the director whose place shall have become vacant and until the election of a successor.

The Board of Directors shall have power to hold their meetings outside of the State of New Jersey at such place or places as may be from time to time designated by the by-laws or by resolution of the Board of Directors.

The Board of Directors, in its discretion, may submit any contract for the purchase or sale of property, the sale, incumbrance or other disposition of shares of stock, bonds or other obligations to be issued by the corporation, or of any other securities, or for the borrowing of money by the corporation, for authorization, approval or ratification at any annual meeting by the stockholders or at any meeting of the stockholders called for the purpose of considering any such contract, and any contract or act in connection therewith that shall be authorized, approved or be ratified by the vote of the holders of a majority in amount of the capital stock of the company which is represented in person or by proxy at such meeting (provided that a lawful quorum of stockholders be there represented in person or by proxy), shall be as valid and as binding upon the corporation and upon all the stockholders as though it had been authorized, approved and ratified by every stockholder of the corporation.

As authorized by the act of the Legislature of the State of New Jersey, passed March 22, 1901, amending the Seventeenth Section of the Act concerning Corporations (Revision of 1896), any action which theretofore required the consent of the holders of two-thirds of the stock at any meeting after notice having been given, or required their consent in writing to be filed, may be taken, upon the consent of and the consent given and filed by the holders of two-thirds of the stock represented at such meeting, in person or by proxy; provided, that the consent or approval of a majority or of two-thirds of the stock of the corporation at the time outstanding be not required by the provisions hereof, in respect of some action herein provided for.

Any officer elected or appointed by the Board of Directors may be removed at any time, with or without cause, by an affirmative vote of two-thirds of the whole Board of Directors. Any other officer or employee may be removed at any time, with or without cause, by the vote of the Board of Directors, or by any committee or superior officer upon whom such power of removal may be conferred by the by-laws, or by a vote of the Board of Directors.

The Board of Directors, by the affirmative vote of a majority of the whole board, may appoint from their number an Executive Committee and a Finance Committee, of each of which committees a majority shall constitute a quorum; and to such extent as shall be provided in the by-laws, such committees shall respectively have and may exercise all or any of the powers of the Board of Directors, including the power to cause the seal of the corporation to be affixed to all papers.

The Board of Directors, by the affirmative vote of a majority of the whole board, may appoint any other standing committees; and such stand-

ing committees shall have and may exercise such powers as may be conferred and authorized by the by-laws or by the Board of Directors.

The Board of Directors may appoint, not only other officers of the corporation, but also one or more Vice-Presidents, one or more Assistant Treasurers, and one or more Assistant Secretaries; and, to the extent provided in the by-laws, or by the Board of Directors, the persons so appointed, respectively, shall have and may exercise all the powers of the President and of the Treasurer and of the Secretary, respectively.

The Board of Directors shall have power, from time to time, to fix and determine and to vary the amount of the working capital of the corporation, and to direct and determine the use and disposition of any surplus or net profits over and above the capital stock paid in.

Except as herein otherwise provided, the Board of Directors shall have power and authority to sell, assign, transfer, convey or otherwise dispose of all or any of the property and assets of the corporation on such terms and conditions as the said Board of Directors shall deem just and expedient, and to issue the bonds, debentures, notes and other obligations or evidences of the debt of the corporation.

With the consent in writing, or by vote at a special meeting of the stockholders called for the purpose, of the holders of not less than two-thirds of the capital stock of the corporation at the time outstanding, the directors of the corporation shall have power to sell, convey or otherwise dispose of all the property, rights and franchises of the corporation as an entirety upon such terms and conditions, and for such considerations, whether in cash, stocks, bonds or other property, as the directors may in their discretion determine.

The Board of Directors, from time to time, shall determine whether and to what extent and at what times and places and under what conditions and regulations the accounts and books of the corporation, or any of them, shall be open to the inspection of the stockholders; and no stockholder shall have any right to inspect any account or book or document of the corporation, except as conferred by statute, or authorized by the Board of Directors, or by resolution of the stockholders.

Subject always to by-laws made by the stockholders, the Board of Directors may make by-laws and, from time to time, may alter, amend, or repeal any by-laws; but any by-laws made by the Board of Directors may be altered or repealed by the stockholders at any annual meeting, or at any special meeting, provided notice of such proposed alteration or repeal be included in the notice of the meeting.

In Witness Whereof, we have hereunto set our hands and seals the 16th day of November, A. D. 1904.

HOWARD K. WOOD. [L. S.]
HORACE S. GOULD. [L. S.]
KENNETH K. MCLAREN. [L. S.]

Signed, sealed and delivered in the presence of

HARRY W. MEEN.

(Acknowledgment.)

(Endorsement and Certificate of Secretary of State.)

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CHAPTER XLIII.

BY-LAW FORMS.

Form 8.—By-Laws. Simple Form.

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BY-LAWS

of the

COLLINGWOOD TOOL COMPANY.

New York City.

ARTICLE I.—STOCK.

1. *Certificates of Stock* shall be issued to each holder of full paid stock, in numerical order, from the stock certificate book, be signed by the President and Treasurer and sealed by the Secretary with the corporate seal. A record of each certificate issued shall be kept on the stub thereof.

2. *Transfers of Stock* shall be made only upon the books of the Company, and before a new certificate is issued the old certificate must be surrendered for cancellation. The stock books of the Company shall be closed for transfers twenty days before general elections and ten days before dividend days.

3. *The Treasury Stock* of the Company shall consist of such issued and outstanding stock of the Company as may be donated to the Company or otherwise acquired, and shall be held subject to disposal by the Board of Directors. Such stock shall neither vote nor participate in dividends while held by the Company.

ARTICLE II.—STOCKHOLDERS.

1. *The Annual Meeting* of the stockholders of this Company shall be held in the principal office of the Company, in New York City, on the second Monday in January of each year, at 12 M., if not a legal holiday; but if a legal holiday, then on the day following.

2. *Special Meetings* of the stockholders may be called at the principal office of the Company at any time by resolution of the Board of Directors, or upon written request of stockholders holding one-third of the outstanding stock.

3. *Notice of Meetings,* written or printed, for every regular or special meeting of the stockholders, shall be prepared and mailed to the last known post-office address of each stockholder not less than ten days before any such meeting, and if for a special meeting, such notice shall state the object or objects thereof. No failure of or irregularity of notice of any regular meeting shall invalidate such meeting or any proceeding thereat.

4. *A Quorum* at any meeting of the stockholders shall consist of a majority of the voting stock of the Company, represented in person or by

proxy. A majority of such quorum shall decide any question that may come before the meeting.

5. *The Election of Directors* shall be held at the annual meeting of stockholders, and shall, after the first election, be conducted by two inspectors of election, appointed by the President for that purpose. The election shall be by ballot, and each stockholder of record shall be entitled to cast one vote for each share of stock held by him.

6. *The Order of Business* at the annual meeting, and, as far as possible, at all other meetings of the stockholders, shall be:

1. Calling of Roll.
2. Proof of due notice of Meeting.
3. Reading and disposal of any unapproved Minutes.
4. Annual Reports of Officers and Committees.
5. Election of Directors.
6. Unfinished Business.
7. New Business.
8. Adjournment.

ARTICLE III.—DIRECTORS.

1. *The Business and Property* of the Company shall be managed by a Board of seven Directors, who shall be stockholders and who shall be elected annually by ballot by the stockholders for the term of one year, and shall serve until the election and acceptance of their duly qualified successors. Any vacancies may be filled by the Board for the unexpired term. Directors shall receive no compensation for their services.

2. *The Regular Meetings* of the Board of Directors shall be held in the principal office of the Company in New York City on the third Tuesday of each month, at 3 P. M., if not a legal holiday; but if a legal holiday, then on the day following.

3. *Special Meetings* of the Board of Directors, to be held in the principal office of the Company in New York City, may be called at any time by the President, or by any three members of the Board, or may be held at any time and place without notice, by unanimous written consent of all the members, or by the presence of all members at such meeting.

4. *Notices* of both regular and special meetings shall be mailed by the Secretary to each member of the Board not less than five days before any such meeting, and notices of special meetings shall state the purposes thereof. No failure or irregularity of notice of any regular meeting shall invalidate such meeting or any proceeding thereat.

5. *A Quorum* at any meeting shall consist of a majority of the entire membership of the Board. A majority of such quorum shall decide any question that may come before the meeting.

6. *Officers of the Company* shall be elected by ballot by the Board of Directors at their first meeting after the election of Directors each year. If any office becomes vacant during the year, the Board of Directors shall fill the same for the unexpired term. The Board of Directors shall fix the compensation of the officers and agents of the Company.

7. *The Order of Business* at any regular or special meeting of the Board of Directors shall be:

1. Reading and disposal of any unapproved Minutes.
2. Reports of Officers and Committees.
3. Unfinished Business.
4. New Business.
5. Adjournment.

Article IV.—Officers.

1. *The Officers of the Company* shall be a President, a Vice-President, a Secretary and a Treasurer, who shall be elected for one year and shall hold office until their successors are elected and qualify. The position of Secretary and Treasurer may be united in one person.

2. *The President* shall preside at all meetings, shall have general supervision of the affairs of the Company, shall sign or countersign all certificates, contracts and other instruments of the Company as authorized by the Board of Directors; shall make reports to the Directors and stockholders and perform all such other duties as are incident to his office or are properly required of him by the Board of Directors. In the absence or disability of the President, the Vice-President shall exercise all his functions.

3. *The Secretary* shall issue notices for all meetings, shall keep their minutes, shall have charge of the seal and the corporate books, shall sign, with the President, such instruments as require such signature, and shall make such reports and perform such other duties as are incident to his office, or are properly required of him by the Board of Directors.

4. *The Treasurer* shall have the custody of all moneys and securities of the Company and shall keep regular books of account and balance the same each month. He shall sign or countersign such instruments as require his signature, shall perform all duties incident to his office or that are properly required of him by the Board, and shall give bond for the faithful performance of his duties in such sum and with such sureties as may be required by the Board of Directors.

Article V.—Dividends and Finance.

1. *Dividends* shall be declared only from the surplus profits at such times as the Board of Directors shall direct, and no dividend shall be declared that will impair the capital of the Company.

2. *The Moneys* of the Company shall be deposited in the name of the Company in such banks or trust companies as the Board of Directors shall designate, and shall be drawn out only by check signed by the Treasurer and countersigned by the President.

Article VI.—Seal.

1. *The Corporate Seal* of the Company shall consist of two concentric circles, between which is the name of the Company, and in the centre shall be inscribed "Incorporated 1904, New York," and such seal, as impressed on the margin hereof, is hereby adopted as the Corporate Seal of the Company.

Article VII.—Amendments.

1. *These By-Laws* may be amended, repealed or altered, in whole or in part, by a majority vote of the entire outstanding stock of the Company, at any regular meeting of the stockholders, or at any special meeting where such action has been announced in the call and notice of such meeting.

2. *The Board of Directors* may adopt additional by-laws in harmony therewith, but shall not alter nor repeal any by-laws adopted by the stockholders of the Company.

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Form 9.—By-Laws. Extended Form.

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BY-LAWS

of the

HAMILTON SILK MILLS COMPANY.

Incorporated under the Laws of New Jersey.

ARTICLE I.—STOCK.

SEC. 1. *Certificates of Stock.*

Each stockholder of the Company whose stock has been paid for in full shall be entitled to a certificate or certificates showing the amount of stock of the Company standing on the books in his name. Each certificate shall be numbered, bear the signatures of the President and Treasurer and the seal of the Company, and be issued in numerical order from the stock certificate book. A full record of each certificate of stock, as issued, must be entered on the corresponding stub of the stock certificate book.

SEC. 2. *Transfers of Stock.*

Transfers of stock shall be made upon the proper stock books of the Company, and must be accompanied by the surrender of the duly endorsed certificate or certificates representing the transferred stock. Surrendered certificates shall be cancelled and attached to the corresponding stubs in the stock certificate book and new certificates issued to the parties entitled thereto. The stock books shall be closed to transfers twenty days before general elections and twenty days before dividend days.

SEC. 3. *Lost Certificates.*

The Board of Directors may order a new certificate or certificates of stock to be issued in the place of any certificate or certificates of the Company alleged to have been lost or destroyed, but in every such case the owner of the lost certificate or certificates shall first cause to be given to the Company a bond in such sum, not less than the par value of such lost or destroyed certificate or certificates of stock, as said Board may direct, as indemnity against any loss or claim that the Company may incur by reason of such issuance of stock certificates; but the Board of Directors may, in their discretion, refuse to replace any lost certificate, save upon the order of some court having jurisdiction in such matter.

SEC. 4. *Stock and Transfer Books.*

The stock and transfer books of the Company shall be kept in its principal office, No. 525 Main street, East Orange, New Jersey, and shall be open during business hours to the inspection of any stockholder of the Company. All other books and records of the Company shall be kept in its office in New York City, and shall include a stock book, which shall be open during business hours to the inspection of any stockholder or judgment creditor of the Company.

SEC. 5. *Preferred Stock.*

The capital stock of this Company shall be One Hundred Thousand Dollars, consisting of One Thousand Shares, each of the par value of One Hundred Dollars. Of these, Five Hundred Shares shall be preferred stock, and Five Hundred Shares shall be common stock.

Said preferred stock shall receive from the net earnings of the Company a six per cent. annual cumulative dividend before any dividends are paid upon the common stock, but such stock shall not entitle the holders thereof to vote at the meetings of the stockholders of the Company.

SEC. 6. *Treasury Stock.*

All issued and outstanding stock of the Company that may be donated to or be purchased by the Company shall be treasury stock, and shall be held subject to disposal by the action of the Board of Directors. Such stock shall neither vote nor participate in dividends while held by the Company.

ARTICLE II.—STOCKHOLDERS.

SEC. 1. *Annual Meetings.*

The regular annual meetings of the stockholders shall be held in the office of the Company, at No. 525 Main street, East Orange, New Jersey, at 12 M., on the second Monday of January in each year, if not a legal holiday; but if a legal holiday, then on the day following. At this meeting the Directors for the ensuing year shall be elected, the officers of the Company shall present their annual reports, and the Secretary shall have on file for inspection and reference an alphabetical list of the stockholders, giving the amount of stock held by each, as shown by the stock books of the Company twenty days before the date of such annual meeting.

SEC. 2. *Special Meetings.*

Special meetings of the stockholders may be held at any time, in the office of the Company, pursuant to a resolution of the Board of Directors, or by a call signed by stockholders holding a majority of the voting stock of the Company. Calls for special meetings shall specify the time, place and object or objects thereof, and no other business than that specified in the call shall be considered at any such meeting.

SEC. 3. *Notice of Meetings.*

A written or printed notice of every regular or special meeting of the stockholders, stating the time and place, and, in case of special meetings, the objects thereof, shall be prepared and mailed by the Secretary, postage prepaid, to the last known post-office address of each stockholder, at least ten days before the date of any such meeting. No failure or irregularity of notice of any regular meeting shall invalidate the same or any proceeding thereat.

SEC. 4. *Voting.*

Only stockholders of record shall be entitled to vote at the regular and special meetings of stockholders. At such meetings each stockholder shall be entitled to one vote for each share of stock held in his name.

SEC. 5. *Election of Directors.*

At the first meeting of the stockholders a Board of seven Directors shall be elected, who shall serve until the election and acceptance of their duly qualified successors. Thereafter, at each annual meeting of the stockholders of the Company, seven Directors shall be elected, who shall serve until the election and acceptance of their duly qualified successors. All elections for Directors shall be by ballot, and the candidates, to the number to be elected, receiving the highest number of votes, shall be declared elected.

If for any reason Directors are not elected at the regular meeting of stockholders, a special meeting shall be called for the purpose within thirty

days thereafter, at which Directors shall be elected in all respects as at the annual meeting.

Two inspectors of election shall be appointed by the President to conduct the election of Directors to serve for the ensuing year. These inspectors shall be sworn to the faithful discharge of their duty and shall then take charge of the election. No person who is a candidate for the office of Director shall act as an inspector of election.

SEC. 6. *Quorum.*

A majority of the outstanding stock, exclusive of treasury stock, shall be necessary to constitute a quorum at meetings of stockholders. When a quorum is present at any meeting, a majority of the stock represented thereat shall decide any question brought before such meeting. In the absence of a quorum those present may adjourn the meeting from day to day, but until a quorum is secured may transact no business.

SEC. 7. *Proxies.*

Any stockholder entitled to vote may be represented at any regular or special meeting of stockholders by a duly executed proxy. Proxies shall be in writing and properly signed, but shall require no other attestation. No proxy shall be recognized unless executed within eleven months of the date of the meeting at which it is presented.

SEC. 8. *Officers of Meetings.*

The President, if present, shall preside at all meetings of the stockholders. In his absence, the next officer in due order who may be present shall preside. For the purposes of these by-laws, the due order of officers shall be as follows: President, Vice-President and Treasurer.

The Secretary of the Company shall keep a faithful record of the proceedings of all stockholders' meetings.

SEC. 9. *Order of Business.*

The order of business at the annual meeting, and, so far as practicable, at all other meetings of the stockholders, shall be as follows:

1. Calling of Roll.
2. Proof of due notice of Meeting.
3. Reading and disposal of any unapproved Minutes.
4. Annual Reports of Officers and Committees.
5. Election of Directors.
6. Unfinished Business.
7. New Business.
8. Adjournment.

ARTICLE III.—DIRECTORS.

SEC. 1. *Number and Authority.*

A Board of seven Directors shall be elected, who shall have entire charge of the property, interests, business and transactions of the Company, with full power and authority to manage and conduct the same.

SEC. 2. *Qualifications.*

No person shall be elected, nor shall be competent to act as a Director of this Company, unless he is at the time of election the holder of record of at least one share of its stock. At least one of the Directors of the Company must be resident in the State of New Jersey.

SEC. 3. *Vacancies.*

Any vacancy occurring in the Board of Directors may be filled for the unexpired term by a majority vote of the remaining members. In

event of the membership of the Board falling below the number necessary for a quorum, a special meeting of the stockholders shall be called and such number of Directors shall be elected thereat as may be necessary to restore the membership of the Board to its full number.

SEC. 4. *Regular Meetings.*

The regular meetings of the Board of Directors shall be held in the office of the Company, in the City of New York, at 3 P. M., on the second Monday of each month, if not a legal holiday; but if a legal holiday, then on the day following.

SEC. 5. *Special Meetings.*

Special meetings of the Board of Directors may be held at any time, in the office of the Company, in the City of New York, on the written call of the President or of any three members of the Board. Special meetings may be held at any time and place and without notice, by unanimous consent of the Board.

SEC. 6. *Notice of Meetings.*

The Secretary shall notify each member of the Board of all regular or special meetings, by mailing to each member's last known post-office address, postage prepaid, at least five days before any such meeting, a written or printed notice thereof, giving the time, place and, in case of special meetings, the objects thereof, and no other business shall be considered at any such meeting than shall have been so notified to the members. No failure or irregularity of notice of any regular meeting shall invalidate the same or any proceeding thereat.

SEC. 7. *Quorum.*

A majority of the Board of Directors shall constitute a quorum, and a majority of the members in attendance at any Board meeting shall, in the presence of a quorum, decide its action. A minority of the Board present at any regular or special meeting may, in the absence of a quorum, adjourn to a later date, but may not transact any business until a quorum has been secured.

SEC. 8. *Election of Officers.*

At the first meeting of the Board of Directors after the election of Directors each year, a President, Vice-President, Secretary, Treasurer, General Manager and Counsel shall be elected to serve for the ensuing year and until the election of their respective successors. Election shall be by ballot, and a majority of the votes cast shall be necessary to elect. If not detrimental to the business or operations of the Company, any two offices may be conferred upon one person. The Directors shall fix the compensation of officers, subject to the limitations of the Charter and the By-Laws. Any vacancies that occur may be filled by the Board for the unexpired term. The Board shall have the right to remove any officer for cause by a two-thirds vote of the entire membership of the Board.

SEC. 9. *Compensation of Directors.*

Each Director shall receive the sum of five dollars as compensation for his attendance at any regular or special meeting of the Board of Directors, and shall receive no other salary or compensation for his services as a Director of the Company.

SEC. 10. *Power to Pass By-Laws.*

The Board of Directors shall have no power to amend, alter or repeal the by-laws, but may pass such additional by-laws in conformity therewith

as may be necessary or convenient to facilitate the business of the Company.

SEC. 11. *Executive Committee.*

The President, Vice-President and Treasurer shall together constitute an Executive Committee, which shall be a part of the permanent executive organization of the Company, and shall, in the interim between meetings of the Board of Directors, exercise all the powers of that body, in accordance with the general policy of the Company and the directions of the Board.

Meetings of the Executive Committee shall be held on call of the President, or of any two members of the Committee. All of the members of the Committee must be duly notified of meetings, and a majority of the members shall constitute a quorum. The Executive Committee shall keep due record of all meetings and actions of the Committee, and such records shall at all times be open to the inspection of any Director.

SEC. 12. *Corporation Offices.*

The principal office of the Company within the State of New Jersey shall be at 525 Main street, East Orange, and the agent therein and in charge thereof upon whom process may be served shall be the Registration and Trust Company. An office shall also be maintained in New York City, and such other offices for the transaction of its business shall be maintained at such other places, in or outside of said State, as may be determined upon by the Board of Directors.

SEC. 13. *Order of Business.*

The regular order of business at meetings of the Board of Directors shall be as follows:

1. Reading and disposal of any unapproved Minutes.
2. Reports of Officers and Committees.
3. Unfinished Business.
4. New Business.
5. Adjournment.

ARTICLE IV.—OFFICERS.

SEC. 1. *Enumeration, Election and Qualification.*

The officers of the Company shall be a President, Vice-President, Treasurer, Secretary, General Manager and Counsel. These officers shall be elected by the Board of Directors at the first regular meeting after the election of Directors each year, and shall hold office for the term of one year, and until their respective successors are duly elected and qualify. The President and Vice-President shall be elected from among the Board of Directors.

SEC. 2. *The President.*

The President, when present, shall preside at all meetings of the stockholders and of the Board of Directors; shall sign all certificates of stock; shall sign or countersign, as may be necessary, all such bills, notes, checks, contracts and other instruments as may pertain to the ordinary course of the Company's business; and sign, when duly authorized thereto, all contracts, orders, deeds, liens, licenses and other instruments of a special nature.

He may also, in the absence or disability of the Treasurer, endorse checks, drafts and other negotiable instruments for deposit or collection, and shall, with the Secretary, sign the minutes of all meetings over which he may have presided.

At the first regular meeting of the Board in January he shall submit a complete report of the operations of the Company for the preceding year, together with a statement of the Company's affairs as existing at the close of such year, and shall submit a similar report at the annual meeting of stockholders; also he shall report to the Board of Directors, from time to time, all such matters coming within his notice and relating to the interests of the Company as should be brought to the attention of the Board.

He shall be *ex officio,* a member of all standing committees, shall have such usual powers of supervision and management as may pertain to the office of President, and perform such other duties as may be properly required of him by the Board of Directors.

SEC. 3. *The Vice-President.*

The Vice-President shall familiarize himself with the affairs of the Company, and, in the absence, disability or refusal to act of the President, shall possess all of the powers and perform all of the duties of that officer.

SEC. 4. *The Secretary.*

The Secretary shall keep full minutes of all meetings of the stockholders and of the Board of Directors; shall read such minutes at the proper subsequent meetings; shall issue all calls for meetings and notify all officers and Directors of their election; shall have charge of and keep the seal of the corporation, and affix the same to certificates of stock when such certificates are signed by the President and Treasurer, and shall affix the seal, attested by his signature, to such other instruments as may require the same.

He shall keep the stock certificate book and the other usual corporation books, and shall prepare, record, transfer, issue, seal and cancel certificates of stock, as required by the transactions of the Company and its stockholders. He shall also sign with the President all contracts, deeds, licenses and other instruments when so ordered.

He shall make such reports to the Board of Directors as they may request, and shall also prepare such reports and statements as are required by the State laws. He shall make out, twenty days before any election of Directors, a complete list of the stockholders entitled to vote at such election, arranged in alphabetical order, and giving the number of shares of stock that may be voted by each, and shall keep the same open to inspection at the office of the Company until the time of and during the said election. He shall allow any stockholder, on application in business hours, to inspect the stock certificate books, the stock transfer book and the stock ledger.

He shall attend to such correspondence, and to such other duties, as may be incidental to his office, or properly be assigned him by the Board.

He shall receive such salary, not exceeding twelve hundred dollars per annum, as may be fixed by the Board of Directors.

SEC. 5. *The Treasurer.*

The Treasurer shall have the custody of and be responsible for all moneys and securities of the Company; shall keep full and accurate records and accounts in books belonging to the Company, showing the transactions of the Company, its accounts, liabilities and financial condition, and shall see that all expenditures are duly authorized and are evidenced by proper receipts and vouchers. He shall deposit, in the name of the Company, in such depository or depositories as are approved by the Directors, all moneys that may come into his hands for the Company account. His books and accounts shall be open at all times during business hours to the inspection of any Director of the Company.

The Treasurer shall also endorse for collection or deposit all bills, notes, checks and other negotiable instruments of the Company; shall pay out money as may be necessary in the transactions of the Company, either by special or general direction of the Board of Directors, and on checks signed by the President and himself, and shall generally, together with the President, have supervision of the finances of the Company.

He shall also make a full report of the financial condition of the Company for the annual meeting of the stockholders, and shall make such other reports and statements as may be required of him by the Board of Directors or by the laws of the State.

He shall give bond in the sum of five thousand dollars, with sureties satisfactory to the Board of Directors, for the faithful performance of his duties and for the restoration to the Company, in event of his death, resignation or removal from office, of all books, papers, vouchers, money and other property belonging to the Company that may have come into his custody. He shall receive such compensation, not exceeding eighteen hundred dollars per annum, as may be fixed by the Board of Directors.

SEC. 6. *The General Manager.*

The General Manager shall, under the supervision of the Board of Directors and the President, have charge of and manage the active business operations of the Company. He shall perform such further duties and make such reports as may be required of him by the Board of Directors, and shall receive such salary, not exceeding twenty-four hundred dollars per annum, as may be fixed by the Board.

SEC. 7. *Counsel.*

Counsel of the Company shall prepare all such contracts and agreements required in the business of the Company as may be referred to him by its officers, and shall inspect and pass upon all such instruments presented to the Company as may be of sufficient importance to justify such examination; also he shall advise with the officers of the Company in all such legal matters pertaining to the affairs of the Company as may require his consideration. He shall receive such annual retainer, not exceeding six hundred dollars per annum, as may be fixed by the Board of Directors.

ARTICLE V.—DIVIDENDS AND FINANCES.

SEC. 1. *Dividends.*

Dividends shall be declared at such times as the Board may direct, but no dividend shall be declared or paid save from surplus profits remaining after all current liabilities of the Company have been fully paid, nor shall any dividend be declared that would impair the capital of the Company.

SEC. 2. *Reserve Fund.*

No dividend to exceed six per cent. per annum shall be declared by the Board of Directors until there shall have been accumulated from surplus profits a reserve fund of ten thousand dollars, such fund to be used for the extension or enlargement of the business of the Company and the betterment of its plant, or for such other purposes as may be necessary or advisable.

SEC. 3. *Debt.*

No debt shall be contracted, nor liability incurred, nor contract made by or on behalf of this Company in excess of one thousand dollars unless the same be authorized or directed by the by-laws or by a duly recorded two-thirds vote of the entire Board of Directors at a regular meeting, or at a special meeting called for the purpose.

SEC. 4. *Bank Deposits.*

The Treasurer shall deposit the moneys of the Company, as the same may come into his hands, in such depository or depositories as may be designated by the Board of Directors, and such deposits shall be made in the name of the Company, and moneys shall be withdrawn therefrom only by check signed by the Treasurer and countersigned by the President.

ARTICLE VI.—SUNDRY PROVISIONS.

SEC. 1. *Corporate Seal.*

The corporate seal of the Company shall consist of two concentric circles, between which shall be the name of the Company, and in the centre shall be inscribed "Incorporated 1905, New Jersey," and such seal, as impressed on the margin hereof, is hereby adopted as the corporate seal of the Company.

SEC. 2. *Penalties.*

Any officer, director or stockholder who shall disobey or violate any of the provisions of these by-laws shall be fined in an amount not to exceed twenty dollars, such fine to be imposed by the Board of Directors, and if not paid at the time, to be deducted from any salary or dividend then due or that may thereafter become due said person.

SEC. 3. *Amendment.*

These by-laws may be amended, repealed or altered, in whole or in part, at any regular meeting of the stockholders, or at any special meeting where such action has been duly announced in the call, provided that a majority of the entire voting stock of the Company shall vote for such amendment, repeal or alteration.

The Board of Directors shall have no power to amend, alter or repeal the by-laws, but may pass such additional by-laws in conformity therewith as may be necessary or convenient to facilitate the business of the Company.

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Form 10.—By-Laws. Comprehensive Form.

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BY-LAWS

of the

SOUTHERN TEXTILE COMPANY.

Incorporated under the Laws of New Jersey.

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BY-LAWS.

ARTICLE I.—STOCK.

SEC. 1. *Certificates of Stock.*

Each stockholder of the Company whose stock has been paid for in full shall be entitled to a certificate or certificates prepared or approved by the Board of Directors, showing the amount of stock of the Company standing on the books in his name. Each certificate shall be numbered, bear the signatures of the President or Vice-President and Treasurer or Assistant Treasurer and the seal of the Company, and be issued in numerical order from the stock certificate book. A full record of each certificate of stock, as issued, must be entered on the corresponding stub of the stock certificate book.

SEC. 2. *Transfers of Stock.*

Transfers of stock shall be made upon the proper stock books of the Company and must be accompanied by the surrender of the duly endorsed certificate or certificates representing the transferred stock. Surrendered certificates shall be cancelled and attached to the corresponding stubs in the stock certificate book, and new certificates issued to the parties entitled thereto. The stock books shall be closed to transfers twenty days before general elections and twenty days before dividend days.

SEC. 3. *Transfer Agent and Registrar.*

The Board of Directors or the Finance Committee may appoint a Transfer Agent and Registrar of Transfers, and may require all stock certificates to bear the signature of such appointee.

SEC. 4. *Regulation of Transfers.*

The Board of Directors and the Finance Committee shall have power and authority to make all such further rules and regulations as they may respectively deem expedient to govern the issue, transfer and registration of stock certificates.

SEC. 5. *Stock and Transfer Books.*

The stock and transfer books of the Company shall be kept in the principal office of the Company, No. 15 Exchange place, in Jersey City, New Jersey, and shall be open during business hours to the inspection of any stockholder of the Company. All other books and records of the Company shall be kept in its office in New York City, and shall include a stock book, which shall be open during business hours to the inspection of any stockholder or judgment creditor of the Company.

SEC. 6. *Lost Certificates.*

The Board of Directors may order a new certificate or certificates of stock to be issued in the place of any certificate or certificates of the Company alleged to have been lost or destroyed, but in every such case the owner of the lost certificate or certificates shall first cause to be given to the Company a bond, with one or more responsible sureties, in such sum, not less than double the par value of such lost or destroyed certificate or certificates of stock, as said Board may direct, as indemnity against any loss

or claim that the Company may incur by reason of such issuance of new stock certificates; but the Board of Directors may, in its discretion, refuse to issue such new certificates, save upon the order of some court having jurisdiction in such matter.

SEC. 7. *Treasury Stock.*

All issued and outstanding stock of the Company that may be donated to or purchased by the Company shall be treasury stock, and shall be held subject to disposal by the action of the Board of Directors. Such stock shall neither vote nor participate in dividends while held by the Company.

ARTICLE II.—STOCKHOLDERS.

SEC. 1. *Annual Meeting.*

The regular annual meetings of the stockholders of the Company shall be held at the principal office of the Company in the State of New Jersey, at twelve o'clock noon on the second Monday in January of each year, if not a legal holiday, and, if a legal holiday, then on the next succeeding Monday not a legal holiday, for the purpose of electing Directors, and for the transaction of such other business as may be properly brought before the meeting.

SEC. 2. *Notice of Annual Meeting.*

It shall be the duty of the Secretary to cause notice of the annual meeting to be published once in each of the four calendar weeks next preceding such meeting in at least one newspaper in New York City and in Jersey City; and a written or printed notice of the annual meeting shall be mailed, postage prepaid, to each stockholder of record, not less than ten days before the date of such meeting; but a failure to publish or mail such notice, or any irregularity in such notice, or in the publication thereof, shall not affect the validity of any annual meeting, or of any of the proceedings at any such meeting.

SEC. 3. *Special Meetings.*

Special meetings of the stockholders may be held at any time in the principal office of the Company in New Jersey, by order of the President, or pursuant to a resolution of the Board of Directors, or upon written call signed by stockholders of record owning a majority of the entire outstanding voting stock of the Company. Calls for special meetings shall specify the time, place and object or objects thereof, and no other business than that specified in the call shall be considered at any such meeting.

SEC. 4. *Notice of Special Meeting.*

A written or printed notice of every special meeting of the stockholders, stating the time and place and the objects thereof, shall be prepared and mailed by the Secretary, postage prepaid, to the last known post-office address of each stockholder of record not less than five days before the date of such meeting.

SEC. 5. *Voting.*

At each meeting of the stockholders every stockholder shall be entitled to vote in person or by proxy, and he shall have one vote for each share of stock standing in his name on the books of the Company at the time of the closing of the transfer books for such meeting. The votes for Directors, and, upon demand of any stockholder, the votes upon any question before the meeting, shall be by ballot.

SEC. 6. *Certified List of Stockholders.*

At least ten days prior to each regular meeting of the stockholders a full, true and complete list, in alphabetical order, of all the stockholders entitled to vote at such meeting, indicating the number of shares held by each, shall be prepared and certified by the Secretary. Only the persons in whose names shares of stock stand on the books of the Company at the time of the closing of the transfer books for such meeting shall be evidenced by the list of stockholders so furnished and be entitled to vote in person or by proxy at such meeting. Such list shall be open to inspection by the stockholders at the principal office of the Company during business hours until such election or meeting shall have been held.

SEC. 7. *Proxies.*

Any stockholder entitled to vote at meetings of the stockholders may be represented and vote thereat by proxy appointed by an instrument in writing, subscribed by such stockholder or by his duly authorized attorney, and delivered to the Secretary at or before the time of such meeting. Proxies shall be properly signed and sealed, but shall require no other attestation.

SEC. 8. *Quorum.*

A majority in amount of the stock issued and outstanding, exclusive of treasury stock, represented by the holders of record thereof, in person or by proxy, shall be requisite to constitute a quorum at any meeting of stockholders. When a quorum is present at any such meeting, a majority vote of the stock represented thereat shall decide any matters brought before such meeting.

If a quorum is not present at the time and place fixed by the by-laws for the annual meeting, or fixed by notice as herein provided for a duly called special meeting, a majority in interest of the stockholders present in person or by proxy may adjourn from time to time, without notice other than by announcement at the meeting, until a quorum is secured. At any such adjourned meeting at which a quorum may be present, any business may be transacted which might have been transacted at the meeting as originally called and notified.

SEC. 9. *Officers of Meetings.*

Meetings of the stockholders shall be called to order and presided over by the President; or, in his absence, by one of the Vice-Presidents in the relative order of position; or, in the absence of President and Vice-Presidents, the stockholders present may from their number appoint a presiding officer for that meeting.

The Secretary of the Company shall perform the duties of Secretary at meetings of the stockholders, but, in his absence from any such meeting, the presiding officer shall appoint some suitable person to act as Secretary thereat.

SEC. 10. *Elections.*

The Directors of the Company, to the number to be elected each year, shall be elected by a plurality vote, cast by ballot, at the annual meeting of stockholders for that year. The Directors so elected shall hold office until the expiration of their respective terms or until the election and qualification of their respective successors.

At all elections of Directors the polls shall remain open for at least one hour, unless every stockholder of record has sooner voted in person or by proxy, or in writing has waived the statutory provision.

SEC. 11. *Inspectors of Election.*

Every election of Directors shall be conducted by three Inspectors of Election, appointed by the Board of Directors prior to the time of each meeting at which any such election is held; or, if the Board fail to make such appointment, then by the presiding officer of such meeting prior to the holding of such election. Said Inspectors shall be sworn to the faithful discharge of their duties, shall open and close the polls, pass upon all questions as to proxies, receive and count the ballots, pass upon all questions as to the qualification of voters and the acceptance or rejection of votes, and decide and direct these and all other matters directly pertaining to the election by their majority action. If for any reason any Inspector shall fail to attend at the meeting for which he was appointed, or shall refuse or be unable to serve thereat, then the presiding officer of such meeting shall appoint an Inspector or Inspectors to fill the vacancy or vacancies so caused.

SEC. 12. *Order of Business.*

The order of business at the annual meeting of stockholders, and, so far as practicable, at all other meetings thereof, shall be as follows:

1. Roll Call.
2. Reading and Disposal of any unapproved Minutes.
3. Reports of Officers and Committees.
4. Election of Directors.
5. Unfinished Business.
6. New Business.

ARTICLE III.—DIRECTORS.

SEC. 1. *Number and Qualifications.*

The number of the first Board of Directors shall be fifteen (15), but at any time this number may be increased by by-law provision therefor. No person shall be elected, nor be competent to act as a Director of the Company, unless a stockholder of record at the time of election. If any Director shall cease to be a stockholder of record his term of office shall forthwith determine and cease.

SEC. 2. *General Powers.*

The Board of Directors shall have entire charge of the property, business, interests and general operations of the Company, with full power and authority to manage and conduct the same. In addition thereto and to the specific powers conferred on the Board by the charter and by-laws, the Board of Directors shall have general power to do all such things as may be necessary for the interests of the Company and not inconsistent with the State statutes, or the charter or by-laws of the Company.

SEC. 3. *Classification.*

The Directors may at their discretion divide the membership of the Board into three classes, each consisting of one-third of the whole number. In such case, the allotment of the Directors to the different classes shall be made in such manner as the Board may elect, and the Directors allotted to the first class shall hold office until the annual election of Directors following; the Directors of the second class until the second annual election of Directors following; and the Directors of the third class until the third annual election of Directors following; and at each annual election the successors to each class of Directors whose terms expire in that year shall be elected to hold office for three years, so that the term of office of one class of Directors shall expire in each year. In event of any increase of the number of Directors, one-third of the additional Directors shall be

elected for the then unexpired portion of the term of the Directors of the first class; one-third for the unexpired portion of the term of the Directors of the second class; and one-third for the unexpired portion of the term of the Directors of the third class, so that each class of Directors shall be increased equally.

SEC. 4. *Vacancies.*

In case of any vacancy in any class of Directors through death, resignation, disqualification or other cause, the remaining Directors, by affirmative vote of a majority of the Board of Directors, may elect a successor to hold office for the unexpired portion of the term of the Director whose place shall be vacant, and until the election of a successor by the stockholders of the Company.

In case of any increase in the Board of Directors between the annual elections of Directors, the newly created directorships shall be considered as vacancies and shall be filled forthwith by the Board.

Should the membership of the Board of Directors at any time fall below the number necessary to constitute a quorum, then a special meeting of the stockholders shall be called by the President and such number of Directors shall be elected thereat as may be necessary to restore the Board to its full membership.

SEC. 5. *Place of Meeting.*

Meetings of the Board of Directors shall be held in the office of the Company in New York City, unless with the written consent of the entire membership of the Board, in which case meetings may be held at any place so determined.

SEC. 6. *Regular Meetings.*

Regular meetings of the Board shall be held monthly, at 3 P. M. on the first Tuesday of each month, if not a legal holiday; otherwise on the next succeeding Tuesday not a legal holiday, at the same hour.

SEC. 7. *Notice of Regular Meetings.*

The Secretary shall mail notices of every regular meeting to the last known post-office address of each Director at least five days before such meeting, and such notices shall give the time and place of such meeting; but no failure of such notice or irregularity therein shall affect the validity of any regular meeting or of any of the proceedings thereof.

SEC. 8. *Special Meetings.*

Special meetings of the Board of Directors may be held at any time on call of the President, or on written call of not less than one-third of the Directors at that time in office, or may be held at any time and place, and without notice, by the unanimous written consent of the Board. Such calls or consent shall specify the time, place and object or objects of the meeting.

SEC. 9. *Notice of Special Meetings.*

Notice of every special meeting other than by unanimous written consent shall be mailed to each Director not less than five days before such meeting, or be telegraphed not less than three days before, and such notice shall give the time, place and objects of such special meeting, and no other business shall be transacted thereat than shall have been so notified to the Directors.

SEC. 10. *Quorum.*

A majority of the Board of Directors shall constitute a quorum for the transaction of business, and, in the presence of a quorum, a majority vote

of the members present at any Board meeting shall decide its action. In the absence of a quorum at any meeting of the Board, a majority of those present may adjourn the meeting from time to time, but may transact no other business until a quorum is secured.

SEC. 11. *Election of Officers.*

At the first regular meeting of the Board of Directors after the time fixed for the annual meeting of stockholders each year, or at a special meeting called for the purpose, but after the time for the annual meeting of stockholders, the Board shall elect, by ballot, from their number, a President, who shall also be Chairman of the Executive Committee; one or more Vice-Presidents, a Chairman of the Finance Committee, a Secretary, an Assistant Secretary, a Treasurer, an Assistant Treasurer, an Auditor, a General Counsel, and the elective members of the Executive and Finance Committees. The Board shall also elect such other officers as may, in the discretion of the Board, be deemed necessary. The Board shall fix the compensation of officers and may fill any vacancies among the officers for the unexpired term.

SEC. 12. *Removal of Officers.*

Any officer, agent or employee of the Company shall be subject to removal at any time, with or without cause, by the affirmative vote of a majority of the whole Board of Directors.

SEC. 13. *Compensation of Directors.*

Directors and members of the Executive and Finance Committees, as such, shall receive no stated salaries for their services, but shall be allowed ten dollars each for attendance at either regular or special meetings if present at roll call and thereafter until adjournment, or until sooner excused. Directors residing outside the City of New York shall, in addition, receive their actual traveling expenses.

SEC. 14. *Working Capital and Surplus.*

The Directors shall have power from time to time to fix and determine and to vary the amount of the working capital of the Company, and to direct and determine the use and disposition of any surplus or net profits over and above the paid-in capital stock; and, in its discretion, the Board of Directors may use and apply any such surplus or accumulated profits in purchasing or acquiring the Company's bonds or other obligations or shares of its own capital stock, to such extent and in such manner and upon such terms as the Board of Directors shall deem expedient; but shares of such capital stock so purchased or acquired may be resold unless such shares shall have been retired, as provided by law, for the purpose of decreasing the Company's capital stock.

SEC. 15. *Inspection of Books.*

The Board of Directors shall determine the conditions and regulations under which the books and accounts of the Company, or any of them, shall be open to the inspection of stockholders of the Company; but no such books and accounts, except the stock and transfer books, shall be open to the inspection of any stockholder holding less than five hundred shares of the Company's stock.

SEC. 16. *Order of Business.*

The regular order of business at meetings of the Board of Directors shall be as follows:

1. Reading and Disposal of unapproved Minutes.
2. Reports of Officers of the Company.
3. Report of Executive Committee.

4. Report of Finance Committee.
5. Unfinished Business.
6. New Business.
7. Adjournment.

Article IV.—Standing Committees.

Sec. 1. *Executive Committee.*

There shall be an Executive Committee of five or more members, as may be determined by the Board of Directors, consisting of the President of the Company, the Chairman of the Finance Committee, and three or more other members, to be chosen annually by ballot by the Board of Directors from their own number, at the first meeting of the Board after the annual meeting of the stockholders, or as soon thereafter as may be convenient. A majority of the whole number of Directors shall be necessary for an election, and the members so elected shall hold office for the ensuing year and until their successors are elected, unless sooner removed by action of the Directors. The elected members of the Executive Committee may be removed at any time by a majority vote of the whole number of Directors.

Sec. 2. *Powers of the Executive Committee.*

The Executive Committee shall have and exercise, by action of a majority of all its members, all the powers and duties of the Board of Directors when the latter is not in session, save and except as limited by the by-laws, and in such matters as have been delegated to the Finance Committee, or in which specific instructions have previously been given by the Board of Directors.

The Executive Committee shall fix the salaries and compensation to be paid to all agents and employees of the Company, except where otherwise provided in the by-laws or by resolution of the Board of Directors.

The Executive Committee shall have power to order the seal of the corporation to be affixed to all papers which in their judgment may require the same.

The Executive Committee shall not increase, enlarge or extend the plants or operations of the Company except with the express approval of the Finance Committee.

The Executive Committee shall not have power to purchase or contract for any large or unusual quantities of supplies or materials except with the written approval of the Finance Committee.

The Executive Committee shall keep a record of its proceedings, and the same, duly certified by the Secretary, shall be read at the next meeting of the Board of Directors.

Sec. 3. *Officers of Executive Committee.*

The President of the Company shall be *ex officio* a member and Chairman of the Executive Committee, and shall preside at all meetings of the same.

The Chairman of the Finance Committee shall be *ex officio* a member of the Executive Committee, and in the absence of the Chairman shall preside at all meetings of the same.

The Secretary of the Company shall act as Secretary of the Executive Committee and shall call meetings of the said committee on the written request of the President, or of the Chairman of the Finance Committee, or of any two of the members of the Executive Committee.

Sec. 4. *Finance Committee.*

There shall be a Finance Committee of three or more members, as may be determined by the Board of Directors, consisting of the President of the

Company and of two or more other members, to be chosen annually, by ballot, by the Board of Directors, from their own number, at the first meeting of the Board after the annual meeting of the stockholders, or as soon thereafter as may be convenient. A majority of the whole number of Directors shall be necessary for an election, and the members so elected shall hold office for the ensuing year and until their successors are elected. The Board of Directors shall designate one of said elected members to be the Chairman of the Finance Committee, and the Chairman so appointed shall preside over the meetings of that committee.

SEC. 5. *Powers of the Finance Committee.*

The Finance Committee shall have general and special charge and control of all financial affairs of the Company, and shall have and exercise all of the powers of the Board of Directors in such financial matters when the latter is not in session. The Treasurer and the Auditor of the Company shall be under the direct control and supervision of the Finance Committee.

The Finance Committee shall fix all salaries and compensation paid or payable to officials of the Company, except as otherwise provided in these by-laws or fixed by resolution of the Board of Directors.

SEC. 6. *Chairman of Finance Committee.*

The Board of Directors shall designate the Chairman of the Finance Committee, who shall preside over the meetings of that committee, and shall be *ex officio* a member of the Executive Committee. The Chairman of the Finance Committee shall be charged with the general oversight, care and management of the finances and financial affairs of the Company, except as otherwise prescribed in these by-laws, by the Board of Directors, or by the Finance Committee.

SEC. 7. *Vacancies.*

All vacancies in either of the standing committees shall be filled for the unexpired term by the remaining members of such committee, subject to the approval of the Board of Directors at its next meeting.

SEC. 8. *Procedure.*

The standing committees shall fix their respective regulations and rules of procedure, and shall meet where and as provided by such rules, or as provided by the resolution of the Board of Directors; but at every meeting a majority of the whole committee shall be necessary to constitute a quorum, and the affirmative vote of a majority of the whole committee shall be necessary for the adoption of any resolution or course of action. Full minutes of the proceedings at committee meetings shall be kept, and reports made to the Board of Directors when requested.

ARTICLE V.—OFFICERS.

SEC. 1. *Enumeration.*

The executive officers of the Company shall be a President, one or more Vice-Presidents, a Chairman of Finance Committee, a Secretary, a Treasurer, an Auditor, a General Counsel, and such other officers as may from time to time be elected by the Board of Directors.

The Board of Directors, or the Finance Committee, may appoint an Assistant Secretary or more than one Assistant Secretary. Each Assistant Secretary shall have such powers and perform such duties as may be assigned to him by the Board of Directors, or by the Finance Committee.

The Board of Directors, or the Finance Committee, may appoint an Assistant Treasurer, or more than one Assistant Treasurer. Each Assistant

Treasurer shall have such powers and perform such duties as may be assigned to him by the Board of Directors, or by the Finance Committee.

SEC. 2. *Qualifications.*

The President, Chairman of Finance Committee and any Vice-Presidents elected shall be members of the Board of Directors. The other officers may or may not be members of the Board of Directors, at the discretion of the Board.

SEC. 3. *The President.*

The President shall be the chief executive officer of the Company and shall exercise general supervision and administration over all its affairs. He shall when present preside at all meetings of the stockholders and Board of Directors, and shall appoint all special or other committees, save and except the Executive and Finance Committees, unless otherwise ordered by the Board of Directors. He shall, by virtue of his office, be a member and Chairman of the Executive Committee and a member of the Finance Committee. He shall sign and execute all authorized bonds, contracts, agreements and other obligations in the name of the Company, and shall, with the Treasurer or an Assistant Treasurer, sign all certificates of shares in the capital stock of the Company.

He shall submit a complete report of the operations of the Company for the year, and a statement of its affairs as of the 31st day of December preceding, to the Directors at their first meeting in February, and to the stockholders at their annual meeting, each year, and from time to time shall report to the Board all matters within his knowledge which the interests of the Company may require to be brought to their notice.

He shall be *ex officio* a member of all committees, and shall have the general powers and duties of supervision and management usually vested in the president of a corporation.

He shall, as far as may be possible and desirable, familiarize himself with and exercise supervision over the affairs of any other corporations in which this corporation may be interested.

He shall freely consult and advise with the various committees and their Chairmen in regard to the business and interests of the corporation.

SEC. 4. *The Vice-Presidents.*

The Vice-Presidents of the Company shall respectively, in the absence of the President, in order of their rank, be vested with all the powers of the President and be required to perform all his duties. They shall perform such other duties proper to their positions as may be prescribed by the Board of Directors.

SEC. 5. *The Secretary.*

The Secretary shall be sworn to the faithful discharge of his duties, shall keep full minutes of all meetings of the stockholders and Board of Directors, and shall perform the same duty for the Standing Committees when required; he shall give due notice of all meetings of stockholders and Directors, and shall notify all newly elected Directors and officers of their election; he shall have charge of the seal of the corporation and affix the same to certificates of stock when such certificates are duly signed by the proper officers, and shall affix the seal, attested by his signature, to such other instruments as are duly authorized by the Board of Directors, the Executive Committee or the Finance Committee.

He shall have charge of the stock certificate books, the stock transfer books and stock ledgers, and such other books and papers as the Board of Directors may place in his care.

He shall make such reports to the Board of Directors and to the Executive and Finance Committees as may be required of him, and shall prepare,

or have prepared, such reports and statements as are required by the State laws. He shall also make out, twenty days before any election of Directors by the stockholders of the Company, a complete list of the stockholders entitled to vote at such election, arranged in alphabetical order, and giving the number of shares of stock that may be voted by each at such election, and he shall keep said list open to inspection at the office of the Company until the time of and during the said election.

He shall perform all such other duties as are incident to his office or may be assigned him by the Board of Directors, the Executive Committee or the Finance Committee.

SEC. 6. *The Assistant Secretary.*

The Assistant Secretary, when appointed, shall, in the absence, the inability, the neglect or refusal to act of the Secretary, be vested with all the powers and be required to perform all the duties of that official. At other times he shall assist the Secretary in the discharge of his duties, and shall do such other things incidental to the position of Assistant Secretary as may be directed by the Board of Directors or either of the standing committees.

SEC. 7. *The Treasurer.*

The Treasurer shall be the custodian of the funds and securities of the Company, except as otherwise directed by the Board of Directors, and shall be responsible for all moneys and other property of the Company under his charge; he shall keep full and accurate records and accounts, in books belonging to the Company, of all receipts, disbursements, credits, assets, liabilities and general financial transactions of the Company; he shall deposit all moneys and other valuable effects of the Company coming into his hands in such depositaries as may be designated by the Board of Directors or by the Finance Committee. His books and accounts shall be open at all times during business hours to the inspection of any Directors of the Company.

He shall disburse the funds of the Company as may be ordered by the specific or general instructions of the Board of Directors or the Finance Committee, taking proper vouchers for all such disbursements; he shall endorse for collection or deposit all bills, notes, checks and other negotiable instruments of the Company, and deposit the same to the Company's credit; he shall sign all receipts and vouchers for payments made the Company, and shall, jointly with such other officer as may be designated by the Finance Committee, sign all checks made by the Company; he shall sign, with the President, or with such other person or persons as may be designated for the purpose by the Board of Directors or Finance Committee, all bills of exchange, promissory notes and bonds of the Company, and shall sign with the President, or with a duly authorized Vice-President, all certificates of shares of the Company's capital stock.

He shall give bond to the Company in such sum, and with such sureties, and in such form, as shall be satisfactory to the Finance Committee, for the faithful performance of the duties of his office, and for the restoration to the Company, in the event of his death, resignation or removal from office, of all books, papers, vouchers, money and other property of whatever kind in his custody and belonging to the Company.

He shall render to the Directors and to the Finance Committee, as called for, all such statements and accounts as may be required of him; shall prepare an annual report showing the financial condition of the Company on the 31st day of December in each year, which report when made shall be presented to the next succeeding meeting of the Board of Directors and to the annual meeting of stockholders; and shall make such other reports and do such other things incidental to his position as may be required of him by the Board of Directors or by the Finance Committee.

SEC. 8. *The Assistant Treasurer.*

The Assistant Treasurer, when appointed, shall, in the absence, the inability, the neglect or refusal to act of the Treasurer, be vested with all the powers and be required to perform all the duties of that official. At other times he shall assist the Treasurer in the discharge of his duties, and shall do such other things incidental to the position as may be directed by the Board of Directors or Finance Committee. He shall give bond to the Company in such amount and in such form and with such security as may be prescribed by the Finance Committee.

Should other Assistant Treasurers be appointed by the Board, they shall have such powers and perform such duties connected with the financial administration of the Company as may be assigned to them by the Board of Directors or the Finance Committee, and the Directors shall have power to assign to any such assistant official such of the powers and duties of the Treasurer as may in their judgment be necessary or expedient.

SEC. 9. *The Auditor.*

The Auditor shall have supervision over the account books, and over all books and papers relating thereto, subject to the Finance Committee, and shall examine all vouchers and audit all accounts. He shall keep such records of the business of the Company as will at all times show the condition of its accounts. He shall render statements to the President and to the Finance and Executive Committees as may be required, showing all disbursements and the amount of money due to the Company from all sources, or otherwise remaining to the credit of the Company, and he shall make such reports and statements as may be required of him from time to time.

He shall, when requested, furnish the Board of Directors or Executive or Finance Committees, a statement of the earnings and expenses of the corporation, or of any company or companies controlled by this corporation, and shall have such books and statistics kept as may be necessary for this purpose.

He shall verify the assets reported by the Treasurer at least twice a year, and make report of the same to the Board of Directors and to the Finance Committee.

He shall cause the books and accounts of all officers and agents charged with the receipt or disbursement of money to be examined as often as practicable, or when requested by the President or Finance Committee, and shall ascertain whether or not the cash and vouchers covering the balance are actually on hand.

He shall render such assistance and advice as the President, Finance Committee or Executive Committee may desire concerning the books and accounts and financial systems of all corporations in which this corporation is interested.

In case of any default within his information he shall forthwith notify the President.

SEC. 10. *The General Counsel.*

The General Counsel shall be the chief consulting officer of the Company in all legal matters, and, subject to the Board of Directors and Finance Committee, shall have general control of all matters of legal import concerning the Company. He shall prepare or supervise the preparation of all important instruments required in the operations of the Company, and shall inspect and pass upon all such instruments presented for the acceptance of the Company as may be of sufficient importance to justify such examination; he shall have general direction and control for the Company of all litigation in which its interests may be involved, and shall advise with the officers of the Company in all such matters relating to the Company's affairs as may require legal consideration.

He shall be present at all meetings of the stockholders and Directors, and give such legal opinions and advice thereat as may be necessary; he shall also attend meetings of the Executive and Finance Committees when requested to attend by the Chairman of those committees, or when so directed by the Board, and he shall perform such other legal duties in connection with the affairs of the Company as may be requested of him by the Board of Directors or Finance Committee.

SEC. 11. *Delegation of Duties.*

In case of the absence, the disability, or the refusal to act of any officer of the Company, the Board of Directors, or Executive Committee, or, in case of a financial officer, the Finance Committee, may delegate his powers and duties to any other officer or officers, or to any Director or Directors, for the time and until the proper official returns, or his successor is elected.

ARTICLE VI.—DIVIDENDS AND FINANCES.

SEC. 1. *Dividends.*

The Board of Directors, in its discretion, may declare dividends from the surplus or net profits of the Company over and above the amount which from time to time may be fixed by the Board as the amount to be reserved for working capital.

SEC. 2. *Working Capital and Surplus.*

The Board of Directors shall reserve from the surplus or net profits of the Company such amount for working capital as may from time to time be fixed by resolution, and shall not be required in January of each year to declare a dividend of the whole of its accumulated profit.

SEC. 3. *Depositaries.*

The Finance Committee or the Board of Directors shall from time to time designate the depositaries of the Company, and the Treasurer of the Company shall deposit the Company funds therein, in the name of the Company, in such manner and amounts as may be provided.
for the time and until the proper official again performs his duties or his successor is elected.

ARTICLE VII.—SUNDRY PROVISIONS.

SEC. 1. *Offices of Company.*

The principal office of the Company in the State of New Jersey shall be at No. 15 Exchange Place, Jersey City, New Jersey.

The principal office of the Company in the State of New York shall be in the City of New York.

The Company may also have offices at such other places as the Board of Directors may from time to time appoint.

SEC. 2. *Corporate Seal.*

The Corporate Seal of the Company shall consist of two concentric circles with the name of the Company between, and in the centre shall be inscribed "Incorporated 1904. New Jersey," and such seal, as impressed on the margin hereof, is hereby adopted as the Corporate Seal of the Company.

SEC. 3. *Amendment.*

These by-laws may be amended, repealed or altered, in whole or in part, at any regular meeting of the stockholders, or at any special meeting where such action has been duly announced in the call for such meeting.

Subject to these by-laws, the Board of Directors shall have power to make additional by-laws of the Company and to amend and repeal by-laws so made, but shall not have power to amend or repeal any by-laws adopted by the stockholders.

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CHAPTER XLIV.

UNDERWRITING AGREEMENTS.

Form 11.—Underwriting Agreement. United States Shipbuilding Company.

.....

THE UNITED STATES SHIPBUILDING COMPANY.

A corporation to be organized under the laws of the State of New Jersey, either by that or some similar name, proposes to acquire the plants and equipment of the following concerns, or their capital stocks, free from any liens:

The Union Iron Works	San Francisco, California.
The Bath Iron Works, Limited, and The Hyde Windlass Company,	Bath, Maine.
The Crescent Ship Yard, and The Samuel L. Moore & Sons Co.,	Elizabethport, New Jersey.
The Eastern Shipbuilding Company	New London, Connecticut.
The Harlan & Hollingsworth Co. and The Canda Manufacturing Company	Wilmington, Delaware. Carteret, New Jersey.

Underwriting Agreement.

For $9,000,000 Series A First Mortgage, Five Per Cent. Sinking Fund, Gold Bonds, due 1932, part of an authorized issue of $16,000,000, Bonds of $1,000 each, $5,500,000 being withdrawn from public issue for disposal under the Vendor's and Subscribers' Contracts, and $1,500,000 being Reserved in the Treasury of the Company. Additional Bonds may be issued only for the purpose of acquiring Additional Plants and Equipment and for Improvements and Betterments, upon such Terms and Conditions as shall be Approved by the Holders of a Majority of the Bonds under the Present Issue Outstanding at the Time of such Approval.

We, the undersigned, each for himself, with The Mercantile Trust Company, for itself and for the United States Shipbuilding Company, and to and with each other, agree to subscribe to, receive and pay for the amount of five per cent. first mortgage, sinking fund, gold bonds of the United States Shipbuilding Company of one thousand dollars each, set opposite our respective signatures hereto, at the price of $900 for each bond, 25 per cent. to be paid upon allotment and the balance upon the demand of The Mercantile Trust Company.

We further agree to receive and pay for any smaller amount than that subscribed for which may be allotted to us respectively.

The conditions of this underwriting agreement are as follows:

(1) That this agreement shall not be binding upon the undersigned unless the entire amount of $9,000,000 of bonds shall have been underwritten.

(2) That within such reasonable time as shall be fixed by The Mercantile Trust Company the said $9,000,000 of bonds, less any amount withdrawn by the underwriters, as hereinafter set forth, will be offered to the public, through such banker or bankers or brokers as shall be designated by The Mercantile Trust Company, for subscription at not less than 95 per cent.

(3) With the consent of The Mercantile Trust Company, any other concern may be included in this combination, or others substituted therefor, provided the working efficiency or values are not lessened or impaired.

(4) That, if the amount of bonds subscribed and paid for upon such public issues shall be at least equal to the amount of bonds so offered to the public, then all liability under this agreement shall cease.

(5) That, in case the amount of bonds subscribed for upon such public offering shall be less than the total amount of bonds so offered to the public, or in case the bonds subscribed for upon such public issue shall not be paid for to an amount equal, at the rate of 95 per cent., to the total of such public offering, then such deficiency in subscriptions and payments will, upon the demand of The Mercantile Trust Company, be made good by the subscribers hereto in the manner aforesaid, *pro rata* in the proportion their subscriptions for bonds not withdrawn by them from public issue bear to the total amount of bonds so offered to the public.

(6) That each underwriter shall receive in preferred and common stock of the United States Shipbuilding Company 25 per cent. of the par value of the bonds hereby underwritten in each kind of stock, and also that all the proceeds, not to exceed 5 per cent., realized from the sale of the bonds at public issue in excess of 90 per cent., after deducting issue expenses, shall belong to the underwriters.

(7) That any underwriter shall have the option of withdrawing from the public issue any of the bonds hereby underwritten by him, provided that he notify The Mercantile Trust Company five days prior to the date fixed for the public issue, that he elects to purchase said bonds, provided that, in the proportion of the bonds so purchased, he waives his said right to participate in the cash proceeds realized from the public issue.

(8) That no underwriter shall sell or offer for sale the bonds so purchased, nor any of the bonus shares he receives, until twelve months after the date of payment, without the consent of The Mercantile Trust Company.

New York, April 19, 1902.

NAME.	ADDRESS.	BONDS UNDERWRITTEN.

Form 12.—Underwriting Agreement. Globe Telegraph Company.

.....

THE GLOBE TELEGRAPH COMPANY.

A corporation to be organized in the State of New Jersey, or in such other State as may be agreed upon, under the name "Globe Telegraph Company," or such other name as may be adopted therefor, to acquire all United States patents for the Alwyn System of Rapid Telegraphy, to build and operate Telegraph Lines, etc.

Capital Stock $15,000,000
Common $8,000,000
Preferred 7,000,000
Six Per Cent., Non-Cumulative, Voting.

Stock full paid and non-assessable.
Shares, $100.

In Treasury of Company..... $12,000,000
Preferred $7,000,000
Common 5,000,000

Withdrawn from Public Issue under Contract with Vendors:
Common Stock $3,000,000

To raise funds for the purposes of the Company, $6,000,000 of Preferred Stock, with a bonus of $3,000,000 of Common Stock, is now offered for underwriting as set forth below, leaving in the Treasury of the Company $1,000,000 of Preferred Stock and $2,000,000 of Common Stock.

Underwriting Agreement.

We, the undersigned, each for himself, agree with the Standard Trust Company, of New York City, for itself and for the Globe Telegraph Company, and to and with each other, to subscribe to, receive and pay for the amount of 6 Per Cent., Non-cumulative, Preferred Stock of the Globe Telegraph Company, set opposite our respective signatures hereto, at the price of $95 for each $100 share; 25 per cent. to be paid on allotment and the balance upon call of the said Standard Trust Company; but no call to be made until after four months from date of allotment and no single call to be for more than 25 per cent.; thirty days' notice to be given prior to any call, and the interval between calls to be not less than three months.

We further agree to receive and pay for any smaller amount than that subscribed for, which may be allotted to us respectively.

The conditions of this Underwriting Agreement are as follows:

(1) That this agreement shall not be binding until at least $2,000,000 face value of said preferred stock shall have been underwritten hereunder, and the subscribers hereunto formally notified thereof by the said Standard Trust Company.

(2) That any underwriter shall have the option of withdrawing from the public offering hereinafter provided for any of the preferred stock hereby underwritten by him, provided that he notify the Standard Trust Company, in writing, not less than ten days prior to the date fixed for said public offering, that he elects to so withdraw said preferred stock, and the stock so withdrawn shall be paid for as hereinbefore set forth.

(3) That within such reasonable time as shall be fixed by the said Standard Trust Company, the preferred stock hereby underwritten, less any amount withdrawn by the underwriters, shall be offered to the public through such banker or bankers or brokers as shall be designated by the said Standard Trust Company, at such price in excess of $95 per share, and with such bonus of common stock therewith, as may be agreed upon between the said Standard Trust Company and a majority in interest of the unwithdrawn stock hereby underwritten.

(4) That if the amount of preferred stock subscribed for upon such public offering, and paid for, shall be at least equal to the amount of preferred stock not withdrawn and offered to the public as above provided, then all liability under this agreement shall cease except as to stock withdrawn from public offering.

(5) That in case the preferred stock subscribed for upon said public offering, and paid for at the demanded price, shall be less than the total amount of the withdrawn preferred stock so offered, then upon demand of the said Standard Trust Company, such stock remaining unsubscribed or unpaid for shall be taken and paid for by the subscribers hereto at the rate of $95 per share, and upon the terms hereinbefore set forth, in proportion to, but only up to the amounts of, their respective subscriptions not withdrawn from public offering.

(6) That from the proceeds of the withdrawn preferred stock, sold as aforeprovided at public sale, and paid for, such amount or amounts shall be paid so soon as it may be done, to the underwriters of the stock so sold and paid for, as shall respectively and fully reimburse them for any installments paid by them upon said stock under the terms of this agreement.

(7) That each underwriter shall receive with each two shares of preferred stock withdrawn or paid for by him one share of common stock.

(8) That all proceeds in excess of $95 per share, after deduction of all issue expenses, realized from the sale of preferred stock underwritten hereunder and sold at public offering as aforeprovided, and such portion of the common stock attaching as a bonus to the preferred stock underwritten hereunder, not given as a bonus to subscribers on public issue, or delivered with, or held for, preferred stock withdrawn, shall belong to the underwriters hereunder, and shall be delivered to them in proportion to their respective subscriptions not withdrawn from public offering.

(9) That stock withdrawn or paid for as hereinbefore provided shall be held by the Standard Trust Company until full payment be made therefor, and until delivery is made of the stock subscribed at public offering, when such withdrawn or paid-for stock shall be delivered to the owners thereof.

(10) That this agreement may be executed in separate instruments with the same force and effect and individual obligation as if all the signatures thereto were affixed to a single instrument.

And Whereas, to insure the proper establishment of the Company's business, a Voting Trust is to be formed, to hold and vote the stock of the Globe Telegraph Company for a term of five years, and Trustees' receipts are to be issued for the stock so held and voted;

Now Therefore, we, the undersigned, hereby respectively agree that we will accept and receive, in lieu of the stock hereby subscribed for, said Trustees' receipts to the full amounts of our respective subscriptions hereunder.

New York.

NAME.	ADDRESS.	SHARES.	AMOUNT.
.....			

CHAPTER XLV.

VOTING TRUST AGREEMENTS.

Form 13.—Voting Trust Agreement. Glen Harbor Improvement Company.

.....

VOTING TRUST AGREEMENT.

We, The Undersigned, stockholders of the Glen Harbor Improvement Company, a corporation duly organized under the laws of the State of New York, and having its principal office in the City of Yonkers, in said State of New York, do hereby, in consideration of the premises and of our mutual undertakings as herein set forth, severally agree to transfer and deliver the shares of stock held by each of us in said corporation, to Emmett M. Brown, William Swift and Andrew McBride, all of the said City of Yonkers, as Voting Trustees hereunder, and mutually agree with them and with each other that said Trustees shall hold and vote the said stock for the period of five years from the date hereof, for the purposes and under the following terms and conditions:

1. All stockholders of the said Company may join in the voting trust hereby created, by signing this present agreement and transferring, in whole or in part, the shares of stock held by them in said Company to the said Trustees, under the conditions and for the purposes of this present agreement.

2. Each stockholder in said Company joining this voting trust as aforeprovided shall become a party thereto from the date on which stock owned by such stockholder in said Company shall be transferred and delivered to said Trustees for the purposes of this agreement.

3. The said Trustees shall surrender to the proper officer of the said Glen Harbor Improvement Company, for cancellation, the certificates for all shares of stock transferred to said Trustees, and shall, in place thereof, have certificates of said Company issued to themselves as Trustees, and on the face of each said Trustees' certificate shall be stated the fact that such certificate has been issued pursuant to this agreement.

4. The said Trustees shall collect and receive all dividends and profits accruing to said stock and shall pay over the same to the respective equitable owners thereof.

5. The said Trustees shall issue to each stockholder becoming a party thereto one or more transferable Trustees' receipts for the number of shares of stock placed by each of said stockholders respectively in this voting trust, and when such Trustees' receipts are duly transferred to other parties, said Trustees shall recognize such other parties as the lawful assigns and successors of the original parties hereto, entitled to all of their rights in the premises.

6. The stock held under this agreement shall, except as hereinafter specially provided, be voted at any meeting of the stockholders of said Company by such of the said Trustees as may be present thereat, and said

vote shall be cast as in the judgment of a majority of the said Trustees present at any such meetings may be for the best interests of the stockholders subscribing to this agreement.

7. In all elections for Directors the said stock shall be voted for the re-election of the present members of the Board of Directors of said Company, or, in the event of the death, disability or refusal to serve of any such members, the said stock shall be voted for such other person or persons as, in the judgment of said Trustees, shall be most suitable for such office.

8. This agreement shall terminate five years from the date hereof, and upon such termination the said Trustees shall, as the outstanding Trustees' receipts are surrendered to them, duly endorsed, give over to the said Company the certificates of stock held by said Trustees, in pursuance of this agreement, properly endorsed, and shall direct the officers of said Company to deliver to the respective owners of the said surrendered Trustees' receipts certificates for such number of shares of stock as may be necessary to satisfy the requirements of the said surrendered Trustees' receipts.

9. In event of the death, disability, resignation or refusal to act of any of the Trustees herein named, the remaining Trustees, or Trustee, shall have power to suitably fill such vacancy or vacancies, and the person or persons so appointed shall be empowered and authorized to act hereunder in all respects as if originally named herein.

10. A duplicate of this agreement shall be filed in the principal office of the said Company in Yonkers and shall there be kept for the inspection of any stockholder of the Company, daily, during business hours.

In Testimony Whereof, the parties to this agreement have hereunto affixed their hands and seals in the said City of Yonkers this 27th day of September, 1902.

VOTING TRUSTEES.		STOCKHOLDERS.		SHARES TRANSFERRED.
EMMETT M. BROWN.	[L. S.]	JAMES HALSEY.	[L. S.]	50
WILLIAM SWIFT.	[L. S.]	ERNEST JURGENS.	[L. S.]	125
ANDREW MCBRIDE.	[L. S.]	HAROLD M. GILSEY.	[L. S.]	75
		WILLIS M. AMES.	[L. S.]	75

Form 14.—Voting Trust Agreement. Colorado Western Railroad Company.

COLORADO WESTERN RAILROAD COMPANY.

VOTING TRUST AGREEMENT.

Dated June 1, 1904

WILLIS B. ALLEN,
HENRY M. FRANCIS,
JAMES H. ELLIS,
Voting Trustees.

This Agreement, made and entered into on the first day of June, 1904, by and between the holders of the certificates of the capital stock of the

Colorado Western Railroad Company, a corporation organized and existing under the laws of the State of New Jersey, who shall become parties thereto (hereinafter referred to as the stockholders), parties of the first part, and Willis B. Allen, Henry M. Francis and James H. Ellis (hereinafter referred to as the Trustees), parties of the second part.

Whereas, said stockholders deem it to be advisable and for the best interests of all of the stockholders of the Company that the control and supervision of its business shall, for a definite period of time, be vested in trustees; and

Whereas, the said Trustees have agreed, during the period hereinafter named, to endeavor to exercise the authority resulting from the control of the stock transferred to them, pursuant to the terms hereof, to make effective the desires of the said stockholders as hereinbefore recited.

Now, Therefore, This Agreement Witnesseth that, in consideration of the premises, and of the agreements hereinafter contained on the part of the stockholders and of the Trustees, each of the said holders of the certificates of the capital stock of the Colorado Western Railroad Company who shall deposit the same with the Knickerbocker Trust Company, of No. 66 Broadway, in the City of New York (hereinafter called the Depositary), or with such other depositary as shall be appointed as hereinafter provided, agrees for himself and not for the others, but with the others and with the Trustees, and the Trustees agree with the stockholders, as follows:

First—That all certificates of the capital stock of the said Company deposited as aforesaid shall be properly endorsed for transfer on the books of the said Company, and the shares represented thereby shall be duly assigned to the said Trustees, and that the deposit of a certificate of stock shall constitute the depositor a party hereto with the same force and effect as though he had personally signed this agreement.

Second—That after said shares shall have been duly transferred to the said Trustees on the books of the Company, the certificate or certificates therefor shall be returned to and thereafter remain in the custody of the depositary (unless said depositary be changed, as hereinafter provided) for the full term of five years from the first day of June, 1904.

Third—That, during the said period of five years, the legal title and all rights, powers and privileges in, to and over the stock represented by the said certificates, including the right to vote thereon, in person or by proxy, shall be and remain vested in the said Trustees, except as is herein otherwise provided.

Fourth—Upon receiving on deposit hereunder certificates of stock properly endorsed for transfer on the books of said Railroad Company, said depositary, as agent for the Trustees, shall issue to each depositor thereof, or to his assigns, a certificate or certificates of interest in the stock so transferred, representing the number of shares deposited by them respec tively. The certificate of interest to be issued to or upon the direction of those depositing such stock, shall be substantially in the following form:

COLORADO WESTERN RAILROAD COMPANY.

Organized under the laws of the State of New Jersey.

No. .... Shares.

Certificate of interest in stock deposited under agreement of June 1st, 1904.

Willis B. Allen, Henry M. Francis and James H. Ellis, Trustees, by Knickerbocker Trust Company, their agent, having received on deposit certificates of stock of Colorado Western Railroad Company,

of the par value of one hundred dollars ($100) each, for shares, which shares are held under the above mentioned agreement, to the terms of which the holder hereof assents by receiving this certificate.

Hereby certify that is entitled, subject to the provisions of said agreement, to an interest in the stock deposited thereunder, to the extent of the number of shares hereinabove stated.

This certificate entitles the holder to no voting power.

The interest represented thereby is transferable only on the books of the undersigned, kept for that purpose at the office of the Knickerbocker Trust Company, by the holder thereof, in person or by proxy, upon surrender of this certificate, properly endorsed.

Dated 190 .

WILLIS B. ALLEN,
HENRY M. FRANCIS,
JAMES H. ELLIS,
Trustees.

By
KNICKERBOCKER TRUST COMPANY,
Depositary and Transfer Agent,
By.....

The said certificates shall contain endorsements for the transfer of the interest represented thereby substantially in the following form:

For Value Received hereby sell, assign and transfer unto the interest in the shares of the capital stock of the Colorado Western Railroad Company represented by the within certificate, and do hereby irrevocably constitute and appoint attorney to transfer the said interest on the books of the within named Trustees, with full power of substitution in the premises.

Dated 190 .

.....

In presence of

.....

In an appropriate place on the back of the said certificates the following words shall also appear:

NOTICE.—The signature to this assignment must correspond with the name as written upon the face of the certificate in every particular, without alteration or enlargement, or any change whatever.

The Trustees may, in their discretion, procure the said certificates of interest to be listed upon any stock exchange or broker's board; and they may make such changes in the forms thereof as may be necessary for them to conform to the rules of any such exchange or board.

Fifth—The interest represented by any certificate so issued may be transferred by the holder thereof in person or by attorney thereunto duly authorized, and a new certificate or certificates issued therefor by the depositary as agent for the Trustees, but only as therein provided.

Sixth—All dividends that may accrue upon the stock so deposited shall be paid by the Trustees to the said depositary, who shall distribute the same *pro rata* among the holders of said certificates of interest, in the proportion in which they shall severally be entitled thereto.

Seventh—In the event of the death, resignation, incapacity or refusal to act of any of the said Trustees, the surviving or remaining Trustee or

Trustees may designate a successor or successors by certificate in writing, deposited or filed with the said depositary, and after the appointment of such successor Trustee or Trustees, he or they shall have and exercise all of the power and authority herein granted to the Trustees herein named with the same force and effect as though he or they had been originally named as a Trustee or Trustees herein.

Eighth—The said depositary designated herein, or its successor or successors, shall be and remain the agent of the Trustees for the transfer of the said certificates of interest in the capital stock of the said Colorado Western Railroad Company until the expiration of the trust hereby created; and in the event of the refusal or inability of the depositary to act, the Trustees may make such arrangements and agreements as may be advisable for the cancellation of certificates of interest issued by such depositary, and shall have full authority to appoint another depositary to act hereunder in its place, and to authorize and arrange for the delivery by the retiring depositary to the depositary so appointed of all certificates of stock then held hereunder by the former. Upon the acceptance of such appointment the new depositary shall be clothed with all of the power and authority, and be subject to all of the duties and obligations hereby imposed upon the depositary herein named. Any depositary acting hereunder, and its or their successors, shall receive reasonable compensation for its and their services. Any depositary may resign its trust hereunder by giving thirty days' notice in writing of its intention so to do, which notice shall be directed to all and delivered to any one of the Trustees then acting. In the event of such resignation, a successor may be appointed by the Trustees as hereinbefore provided.

Ninth—In exercising their rights, powers and privileges hereunder, the Trustees will use their best judgment from time to time to select suitable Directors of the said Railroad Company, to the end that the affairs of the said Company shall be properly managed and conducted in the interests of all the stockholders of the said Company, and in voting upon all other matters which may come before them at any stockholders' meeting, will exercise like judgment, and will from time to time inform the stockholders regarding the progress and condition of the business of the Company. It is understood, however, that no Trustee shall incur any personal responsibility by reason of any matter or thing done or omitted to be done by him in connection with the execution of said trust, except for his individual malfeasance.

Tenth—The Trustees may make such rules for the transaction of their business hereunder as to them shall seem proper and as shall be in accordance with the terms of this agreement. They may act by a majority of their number at any regular or special meeting convened on notice, or by writing signed by such majority without a formal meeting. The trust hereby created may be terminated at any time by consent of the Trustees, which consent shall be in writing, delivered to and lodged with each of the depositaries which shall then be acting hereunder. Upon such termination, or upon the expiration of the agreement by lapse of time, all shares of stock of the said Railroad Company then on deposit hereunder shall be distributed among the registered holders of the said certificates of interest, upon the surrender of such certificates, duly endorsed, to the depositaries, in such manner that each holder of a certificate or certificates of interest in the said stock shall receive a certificate or certificates for a number of shares of the said stock equal to the number of shares named in his said certificate or certificates of interest.

Eleventh—The Trustees shall not sell, pledge, hypothecate, mortgage or place any lien or charge upon the shares of stock deposited hereunder.

Twelfth—No depositary hereunder shall incur any liability to any of the parties hereto, except for the exercise of ordinary care in the performance of its duties as herein prescribed.

Thirteenth—This instrument, or any other writing required by this instrument to be signed or executed, may be executed in any number of like instruments of similar tenor, each of which so signed shall be treated as an original.

Fourteenth—This agreement shall be binding upon and shall inure to the benefit of the parties hereto, their personal representatives, successors and assigns.

In Witness Whereof, the said Stockholders have either executed these presents or become parties hereto by depositing certificates for their said stock as herein provided, and the said Trustees have hereunto set their hands on the day and date first above mentioned.

STOCKHOLDERS.

NAMES.	RESIDENCES.	NO. OF SHARES.

The undersigned Knickerbocker Trust Company of New York, the depositary named and referred to in the foregoing instrument, hereby acknowledges the receipt of a copy of the said instrument, and notice of all of the terms thereof, and hereby gives its assent to the same and agrees to act as depositary and transfer agent under the terms and conditions therein set forth.

In Witness Whereof, it has caused this consent to be executed by its duly authorized officer and its corporate seal to be hereunto affixed this 1st day of June, 1904.

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